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ABSTRACT

The American Institutes for Research (AIR) and the National Consumer Law Center (NCLC) studied consumer fraud and assessed possible intervention. Phase I produced an AIR description of the nature, scope, and characteristics of consumer fraud and an NCLC compilation of the laws and regulations which control it. In Phase II AIR developed quantitative profiles for twenty-three patterns of consumer offense. An NCLC survey of law enforcement and criminal justice officials concurrently assessed the status and application of twenty-two legal sanctions. The objective of Phase III, and of the project, was to develop strategies effective in combatting abuses of the types revealed in the data. Sixteen selected approaches to intervention were analyzed under six major topics: payment planning, post-sale alternatives, complaint mediation, private remedies, coverage for consumer loss, and document simplification. Each strategy was evaluated against a standard set of criteria: (1) burden on merchant and consumer, (2) ease of implementation, (3) administrative costs, (4) susceptibility to abuse, (5) interface with other interventions, (6) general and specific scope, and (7) pay-off. Implementing actions for private and public sectors are recommended for seven priority targets. Characteristics of Phase I and II data sources and a data acquisition form are appended. (YLB)

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Consumer Fraud: An Empirical Perspective

Summary

by
Jane G. Schubert
and
Robert E. Krug
with the assistance of
Andrew M. Rose

June 1979

CE 022 551

U.S. DEPARTMENT OF HEALTH, EDUCATION & WELFARE
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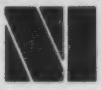

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Consumer Fraud: An Empirical Perspective has been a three-phase study that began in September 1976. The project, sponsored by the Law Enforcement Assistance Administration (LEAA), Community Crime Prevention Division, represents a combined effort of the American Institutes for Research (AIR), Washington, D.C., and the National Consumer Law Center (NCLC), Boston, Massachusetts.

As with any project this size, the products reflect the contributions of many individuals. We are grateful to each of them.

A panel of experts which represents law enforcement agencies, consumer organizations, and private sector groups met periodically, both to review project plans and accomplishments and to advise project staff about priorities and directions. The following individuals attended one or more meetings of the Advisory Panel.

Mr. David Austern
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Mr. Dean Determan
Vice President
Council of Better Business Bureaus
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Ms. Barbara Gregg
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New York, N.Y.

Ms. Patton Wheeler
Executive Director
Committee of the Office of Attorney General: NAAG
Raleigh, North Carolina

During the course of this study, we received frequent and thoughtful input and direction from Dr. Fred Heinzelman, Director, Community Crime Prevention Division, LEAA and Mr. Bernard Auchter, Project Monitor.

Mr. Jonathan A. Sheldon, Project Coordinator, was responsible for the daily technical direction and management of NCLC's activities. Overall supervision for technical and administrative matters was held by Mr. Mark Budnitz, Executive Director of NCLC. Mr. George J. Zweibel worked with the project staff in AIR's Washington Office as an on-site advisor on matters that required legal expertise. Other NCLC participants on short-term tasks were: Lynne B. Adams, Richard Alpert, Geraldine Azzata, Robert J. Hobbs, Mark Leymasters, Kenneth Reeves, and Wendy Schiller.

The AIR Project Director was Dr. Jane G. Schubert, who supervised on-going technical and administrative activities on a daily basis. Dr. Robert E. Krug served as the Principal Investigator and was responsible for all technical aspects of the project. He succeeded Dr. David J. Klaus, Principal Investigator during Phase I. The Network Approach and other creative concepts were contributed by Dr. Andrew M. Rose. Several analytic procedures such as cluster analysis and the log-linear technique were applied to the data base. They were suggested by Dr. Paul N. Fingerman, who also designed the appropriate computer programs and assisted in the interpretation of the data. Other staff members participated in numerous tasks: Ms. Adele Gill conducted the literature search; Ms. Teri Knotek constructed and maintained the data file; Ms. Tania Romashko conducted site visits; Mr. William Trencher contributed to the development of the intervention strategies.

This summary report, the sixth major product of this research, was prepared by Dr. Robert E. Krug and Dr. Jane G. Schubert, with the assistance of Dr. Andrew M. Rose. As with all other reports, the opinions expressed are those of the authors. They do not represent the opinions or policies of LEAA or other contributors to this project.

Additional reports are:

Schubert, J. G., Rose, A. M., Zweibel, G. J., & Klaus, D. J. *Consumer Fraud: An analysis of impact and opportunities for intervention.* Technical report: Phase I. Washington, D.C.: American Institutes for Research, December 1977.

Sheldon, J. A., & Zweibel, G. J. *Consumer Fraud: An analysis of impact and opportunities for intervention.* Survey of consumer fraud law. Washington, D.C.: American Institutes for Research, September 1977.

Schubert, J. G., Krug, R. E., & Rose, A. M. *Consumer Fraud: An analysis of impact and opportunities for intervention.* Technical report: Phase II. Washington, D.C.: American Institutes for Research, June 1978.

Sheldon, J. *Consumer Fraud: An analysis of impact and opportunities for intervention.* Consumer fraud intervention strategies. Washington, D.C.: American Institutes for Research, June 1978.

Zweibel, G. *Federal agency-by-agency analysis.* November 1978.

PROLOGUE

Two years ago, we set out to study consumer fraud. We actually studied a much broader range of transactions. Many of the events on which this report is based are cases of clear fraud. Many others involve merchant practices which are questionable, but for which a verdict of fraud is debatable. And a few involve a consumer complaint for which there may be no legitimate claim against the merchant. This expansion in scope was not planned at the outset; it occurred naturally in the first phase of the project and was thereafter maintained as intentional policy.

We began by asking agency* representatives to select examples from their case files which they believed to involve consumer fraud. We assembled 383 such cases in our first phase data collection. Our analysis of these cases indicated that

- we were tapping into a serious and pervasive phenomenon that was harmful to a very large number of people, and
- the domain included cases which could not satisfy all legal requirements for proof of fraud.

We decided to be led by our data, hence the claim of *an empirical perspective*. We might have titled our study *Consumer Abuse*, which accurately describes our total sample of some 1,147 cases; but that title would miss the point. An empirical perspective on fraud turns up many instances of abuse which may not support a court verdict of fraud. The domain we studied might be described as that which violates

> *". . . the contract which the law always implies, that every transaction is fair and honest."* (Blackstone's Commentaries)

The overwhelming message of our data is that fraudulent and quasi-fraudulent events appear at the outset to be normal, everyday transactions. There are exceptions, but for the most part there are no signals to the consumer that he or she is about to be taken. This appearance of normalcy is a serious obstacle to the design of remedies. Most transactions are fair and honest, and correcting or preventing those which are not, must not place an unreasonable burden on the honest merchant.

Consumer abuse is pervasive, produces a very large aggregate loss, and is intolerable for the individual victims. Our assessment of possible intervention offers no panacea. Our hope is that the assessment will be used and be useful to those engaged in the continuing effort to reduce the perils of the marketplace.

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* See Appendix A and Appendix B for a list of the agencies.

1. HISTORICAL PERSPECTIVE

1.1 Overall Objectives of the Study

The general plan for the Consumer Fraud project was quite straightforward, consisting essentially of three steps. The purpose of the first phase was to describe the nature, scope, and characteristics of consumer fraud, and of the laws and regulations intended to control it. The second phase was to expand on the first by collecting a larger and more focused set of consumer fraud events and by examining the effectiveness of existing control mechanisms. The purpose of the second phase was to determine the requirements for new or modified prevention and control efforts. The product of the third phase would be a set of recommended approaches or strategies to protect consumers from fraud.

Very early in the effort, we recognized that our attention was being directed *by the accumulating data* to phenomena which could not be encompassed by accepted legal definitions of fraud. We decided to follow the route indicated by the data. Our study therefore covers a domain which includes, but is not limited to, consumer fraud as currently defined.

A summary of Phase I and Phase II activities follows. The efforts of AIR and NCLC are treated separately; each organization worked concurrently on essentially independent tasks during the first two phases.

1.2 Phase I: AIR

1.2.1 GOALS

The tasks assigned to this phase were (1) a collection of case histories that represented examples of situations in which a consumer was allegedly defrauded by a merchant, (2) the development of a descriptive classification scheme of consumer fraud offenses based on those histories, and (3) the creation of a data-based definition of consumer fraud.

1.2.2 ACTIVITIES AND ACCOMPLISHMENTS

With the help of the Advisory Panel, we selected 11 agencies as sources for the case histories.* The sources represented law enforcement agencies, consumer groups, and regulatory agencies, believed to represent the types of offices that handled most consumer complaints and therefore, would provide broad coverage of the kinds of events which might be considered fraudulent. Agency

* A table identifying and characterizing each participating agency appears as Appendix A.

employees who handle consumer cases supplied samples of events where they believed consumer fraud had occurred. We collected 383 cases from the 11 sources. Each case history contained a description of the consumer complaint, an explanation of the investigation conducted by the agency, and a report of the outcome. The cases were summarized into abstracts of one or two pages in length.

The following brief abstracts give some of the flavor of the cases.

- A $22 check accompanied my order for six Bicentennial gold plated dollars . . . acknowledgement of my order and notice of six-month delay in shipment accompanied another offer for more coins . . . eight months following original order, a court-appointed receiver for the company informed me that the company's funds were exhausted and solicited my order of silver plated coins ($33 plus a money-back guarantee) as a first step toward ultimate receipt of my set of gold plated dollars.

- The unusual plants for which I paid $26, were almost dead when they arrived . . . balance of order never received . . . my mail order was prepaid . . . four years later the merchant has not fulfilled the balance of my original order . . . the same ad I responded to still appears in national publications.

- I ordered a radio, stereo, and turntable at a tremendous discount from an incentive program offered through the local educators association . . . mailed a personal check for $267.45 with my order . . . seven months of delays and promises have resulted in no merchandise . . . now there is no phone listing for this "program" organization.

- I have not received my home office storage unit which I ordered by mail six months ago. . . phone calls of inquiry resulted in empty promises of delivery when they caught up with large number of orders received . . . paid special sale price of $395 (reduced from $445) plus $25 shipping charge . . . confirmation received acknowledging payment.

- I purchased an electric clock on sale ($30) because the store was relocating . . . the clock had a one-year guarantee . . . when it stopped running after three days I contacted the new store and was asked to return the clock so it could be sent to the manufacturer for repair . . . six months later I still had no clock . . . during my last conversation with the manager he refused to take action because the clock was purchased on sale . . . he was not responsible for any statements made by the clerk.

- I responded to a telephone solicitation offering brand-name vacuum cleaner bags for a special price prior to an increase . . . I paid in full on delivery . . . when I later opened the package I discovered the bags were of an inferior quality, and were not the brand name offered.

Some of the events are fraudulent. Some violate existing laws, but may not be classed as fraud. Some may not even be illegal. But in each case, a consumer suffered some "hurt", spent additional time and energy, and sometimes additional money in the attempt to obtain satisfaction, and was often unsuccessful. Abuse of the consumer in the marketplace is pervasive, places unreasonable burden on the individual victims, and produces very large aggregate loss. Confronted with these findings, we designed our second phase of data collection to continue to seek examples of fraud, but to accept cases which were turned up by the case selection process, even if they did not satisfy a narrow definition of fraud. We studied abuse of the consumer.

1.2.3 PRODUCT

The major product of this phase was a technical report that detailed the objectives, data collection procedures and analyses, a list of 24 descriptive dimensions, and a refined definition of consumer fraud. The report included sample abstracts, descriptions of each agency source, a bibliography containing 225 entries, and a list of the Advisory Panel members. It also included a preliminary analysis of three classification schemes which would be given a more thorough test in Phase II.

1.3 Phase I: NCLC

1.3.1 GOALS

The Phase I objective was to compile and organize relevant statutes, regulations, and ordinances from federal and representative state and local jurisdictions which attempt to establish certain kinds of behavior as fraudulent.

1.3.2 ACTIVITIES AND ACCOMPLISHMENTS

Several surveys of existing laws which have a bearing on consumer fraud were conducted. In addition to addressing civil and criminal laws at the three government levels, the surveys encompassed administrative regulations and case law.

The federal survey entailed comprehensive research of all federal laws and agencies charged with consumer fraud functions. Preliminary research suggested that 40 federal agencies might have some involvement in consumer fraud. The survey was focused on 20 agencies whose statutory powers and regulations promulgated under them, merited detailed research. Federal Trade Commission law warranted more thorough inspections; therefore, FTC legislation, rules, guides, caselaw, enforcement statements and various secondary materials were scrutinized. For each agency, charts were developed which delineated prohibited practices under the agency's consumer fraud functions and specified remedies for violations.

The state law survey consisted of three major components: (1) an examination of laws prohibiting unfair or deceptive acts or practices (UDAP statutes) in all states, including the District of Columbia; (2) an analysis of all other forms of consumer fraud laws in 12 states and the District of Columbia which collectively represent typical state consumer fraud law;* and (3) a review of the legislation and regulations adopted by approximately 30 licensing boards in a subsample of five states. The 13 jurisdictions provide an adequate cross-section along three variables: geographic location; form of UDAP statute; and amount of state resources devoted to consumer protection. States were chosen from the Northeast, Midwest, South, and West. The states also represent, in approximately correct proportions, the various forms of UDAP statutes enacted throughout the country and include the one state that has not enacted such legislation. In addition, one of the few Uniform Consumer Credit Code states was also selected. Various forms of private and state UDAP remedies and powers are represented in roughly proportional numbers.

The local consumer fraud law survey included two or three towns or counties within each of the 12 target states. The jurisdictions were chosen to provide representation from urban, suburban, small town, and rural areas. Since almost all localities have very limited consumer fraud legislation, a disproportionate number of localities with more extensive consumer fraud laws was selected to allow adequate comparison of various approaches, even if infrequently enacted.

1.3.3 PRODUCT

The document produced at the conclusion of this phase is unique in its class. The five-part volume contains the following sections: 1. Historical Development of Consumer Fraud Law, historical monographs, treatises, and other secondary materials; 2. State Law, an analysis of 67 consumer fraud practices states have targeted for regulation and 33 strategies used to prevent these prohibited practices; 3. Local Enforcement, identifies the various approaches that municipalities and counties take in policing consumer transactions; 4. Federal Law describes both the fraud practices of concern to federal agencies and the strategies utilized to prevent them; it also contains an agency-by-agency analysis summarizing important consumer fraud laws and remedies administered by 28 federal agencies; 5. Foreign Approaches, sets out innovative strategies that foreign jurisdictions have utilized to combat fraud in the marketplace.

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* These states are: Alabama, California, Colorado, Georgia, Illinois, Massachusetts, New Jersey, New York, Ohio, Pennsylvania, Texas, Wisconsin.

1.4 Phase II: AIR

1.4.1 GOALS

The principal aim was to develop quantitative profiles for each pattern of consumer offense. Measurement techniques that might be used to monitor consumer abuse were sought as a secondary objective.

1.4.2 ACTIVITIES AND ACCOMPLISHMENTS

The emphasis shifted from a qualitative phase to a quantitative phase; we collected and processed 942 additional consumer complaints from ten new law enforcement and consumer agencies.* The knowledge gained in Phase I provided a better understanding of information requirements and therefore permitted greater efficiency in data collection. Attention was directed to individual complaint data from files closed less than two years; assembling fractional data from numerous sources permitted the aggregation of data into useful composites. Project staff visited the sites and randomly selected cases from the files; cases that did not contain a description of the transaction between the merchant and the consumer were passed over.

Case data were recorded on a Data Acquisition Form derived from the classification schemes developed in Phase I; each scheme focused on the nature of the *process* of the transaction between merchant and consumer. The process-oriented approach permitted examination of how an abuse was perpetrated by identifying (1) the actions and circumstances which characterized an offense, (2) the sequence of events that set it apart from other types of abuses, and (3) the conditions which allowed a particular type of offense to succeed. Each type of offense would be analyzed as a *profile* of consumer abuse; the profiles were then to be used in generating ideas for intervention strategies.

Although our original intention was to develop one classification scheme using the Phase I data base, we actually developed three schemes, each employing a substantially different approach to analyzing the process of a consumer transaction. We deferred the selection of one scheme until the reliability and utility of each system could be judged with the expanded data base. Consequently, the Data Acquisition Form reflected the distinguishing features of each classification scheme.

The three classification schemes are briefly described on the following page.**

---

* A table identifying and characterizing these sources appears as Appendix B.

** Detailed descriptions appear in the Phase I (AIR) report.

A *thematic* approach categorizes the cases into 15 inductively generated groups based on characteristic merchant actions. As an example, one theme, *Gilded Lily*, contains 39 cases in which claims are made which lead the consumer to believe the product or service will result in more benefits than actually will be received. Because many factors affect outcomes, these claims are difficult to disprove. The key features of this category are that:

- claims typically are implied rather than explicit, and the ads may be literally true;
- the product or service is provided and, generally, the cost is not enormously excessive for what actually is received; and
- although the product or service often has some value, it probably would not have been purchased in the absence of misleading claims.

A *transactional* approach created prototypic transactions from the sequence of events believed to characterize business transactions between a merchant and a consumer. The three major components of a transaction are:

- an inducement: refers to the appeal or the attraction offered by the merchant that led to the consumer's interest;
- an obligation: refers to the action by the consumer that demonstrates a commitment;
- an outcome: refers to the final event which, from the consumer's viewpoint, identifies the major grievance in the transaction.

Each of the major components contains subcategories derived from an iterative process of sorting elements of the cases into similar clusters. For example, all cases were examined for an inducement; similar inducements (such as business opportunity or a substantial savings) were grouped together until all cases had been assigned to a cluster. The same cases were then re-examined for the consumer's obligation to the merchant (such as prepayment prior to delivery or signed agreement with the merchant); similar behaviors were assigned to a cluster until all the cases were used. The data determined the number of piles. The sorting procedure was then repeated to identify outcomes to the transaction. Each case was thus described as an inducement-obligation-outcome combination.

A *network* approach is structured around the characterization of a consumer-merchant transaction in terms of a sequential network of questions and answers. Significant nodes (with respect to both loci of potential countermeasures and critical exchanges in the transaction) were identified from a review of the 383 cases. These nodes were translated into binary questions; a logical sequence for addressing these questions was developed. Each node does not define a type of consumer abuse; we assumed

that specific cases had patterns of answers, and that different types of abuse would manifest themselves as distinctive patterns.

The network approach is illustrated below.

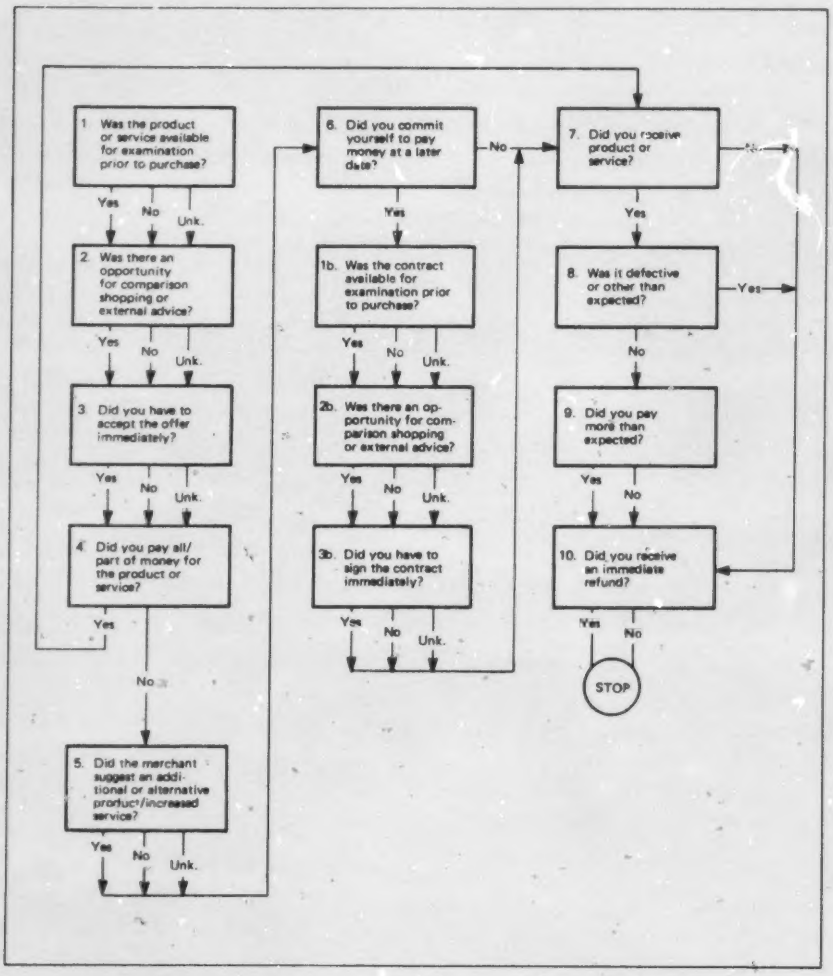

1. Was the product or service available for examination prior to purchase?
Yes
No
Unk.
2. Was there an opportunity for comparison shopping or external advice?
3. Did you have to accept the offer immediately?
4. Did you pay all/part of money for the product or service?
5. Did the merchant suggest an additional or alternative product/increased service?
6. Did you commit yourself to pay money at a later date?
1b. Was the contract available for examination prior to purchase?
2b. Was there an opportunity for comparison shopping or external advice?
3b. Did you have to sign the contract immediately?
7. Did you receive product or service?
8. Was it defective or other than expected?
9. Did you pay more than expected?
10. Did you receive an immediate refund?
STOP

Figure 1. The Network Approach

The 942 cases collected from the ten additional agencies which participated in Phase II fell short of our goal of 1,000 cases, so 252 cases were added from the Phase I data base. Our new data set contained 1,194 cases, after editing and cleaning the data, the usable base consisted of 1,147 cases. Is this data set *representative* of what occurs in the marketplace? The clear answer is "no" for two reasons. First, we have no basis at all for estimating the frequency of abuse as a percentage

of all transactions. A *victimization survey* designed to provide such an estimate would require resources which far exceed those available in this study. Consideration of resource requirements leads us to recommend that surveys would be cost effective only as before and after measures for pilot tests of planned interventions.

Second, we cannot use our data to infer the frequency of some type of abuse, such as auto repair fraud, as a percentage of all abuses. Cases within agency files were selected randomly; the agencies themselves were not selected randomly from a master list of all agencies. We believe our set of agencies to represent a broad coverage for all forms of consumer abuse; but there is no basis for statistical inference from our sample of cases to the population of all cases. We believe our sample to be fully adequate for the purposes intended; we do not claim more than that. The data reflect two general types of information--descriptive and process-oriented. Both were necessary for developing comprehensive patterns of abuse. Our overall impressions of the data are summarized below:

- elegant, ingenious, or complex schemes were noticeably absent from the cases; most events were unimaginative in planning and execution;
- merchant excesses often led to the complaint being filed; many schemes would have "worked" better if the merchant had been less greedy or careless;
- in outward appearances, most cases are indistinguishable from normal, everyday transactions; there are few clues to warn the consumer that he or she is about to be taken;
- the illegality of such behaviors as mislabeling, failure to disclose, or refusing a guaranteed refund, did not deter merchants from using them;
- resolution (if it occurred at all) usually required substantial investment of consumer time and energy; some consumers were extraordinarily patient in trying to get satisfaction from a merchant; complaints to consumer agencies are not made precipitously; and
- while the typical transaction is small (53% of our cases involved less than $100), the aggregate is very large: our 1,147 transactions involved more than $700,000.

The task of choosing the classification scheme which held the most promise for devising intervention strategies still remained. Each of the three systems was analyzed, using the complete data base. An exhaustive discussion of the analyses is contained in the Phase II (AIR) report; briefly, the outcomes were that:

In the *thematic* approach, only 473 (41%) of the cases were uniquely defined by one of the 15 themes. Ninety-three cases (8%) received multiple assignments and the remaining 581 (51%) were not accommodated by the system. As formulated, the thematic approach did not provide an adequate framework.

The primary analytic procedure applied to the *transactional* sequence was to cross-tabulate Inducement x Obligation x Outcome to identify patterns. Nine patterns out of a possible 54 accounted for 67 percent of the cases. In most of the cases, the existence of "warranty" (express or implied) emerged as the inducement for purchase. This really suggests the absence of an external stimulus and indicates that most of our cases began as normal business transactions that turn sour, resulting in a consumer grievance. Warranty was considered as an inducement largely because of the absence of other more specific inducements. There is a qualitative difference between purchase based on a "special opportunity" to save money and one based on the existence of an implied or express warranty. We therefore directed our attention to the remaining two transactional components--obligation and outcome.

In the *network* analysis, it was essential to know something about the patterns of answers to the ten questions. A cluster analysis was performed that grouped "similar" cases by their responses to these questions. Statistically, this was a very successful cluster solution, in that very few patterns could account for practically all of the cases.

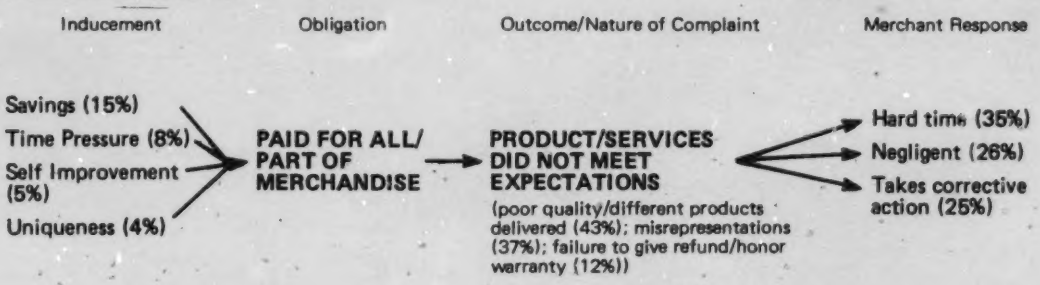
The outcome of the analysis was that the transactional sequence and the network approach seemed to convey similar information; the general summaries were essentially identical. Before proceeding to Phase III tests of utility, a more formal, but simple analysis of similarity between the two approaches was conducted. Based on that analysis, we generated 23 profiles of consumer abuse (9 transactional sequences and 14 network clusters), each set using approximately 90 percent of the 1,147 cases. Each pattern is accompanied by both descriptive and process variables. The significance of the descriptive variables was tested by a likelihood ratio chi square.

Examples of two profiles follow. Statements such as "more than--fewer than--more often", etc., refer to frequencies which differ in a statistically significant manner, from the overall frequencies.

Profile	AC
No. of Cases	311
Percent of Total	24

The consumer paid for all or part of the merchandise or service at the time of the purchase. Upon receipt examination of the goods revealed that they did not correspond to the original offer or the consumer's expectations.

Transactional Sequence



Descriptive Data

- The following products or services were more (+) represented than expected:

  Automotive products (+)
  Home Furnishings (+)

- More sellers appeared in the reported transactions.
- More initial contacts between the merchant and the consumer were made at a business establishment of another involved party.
- The following complaints were over (+) or under (—) represented.

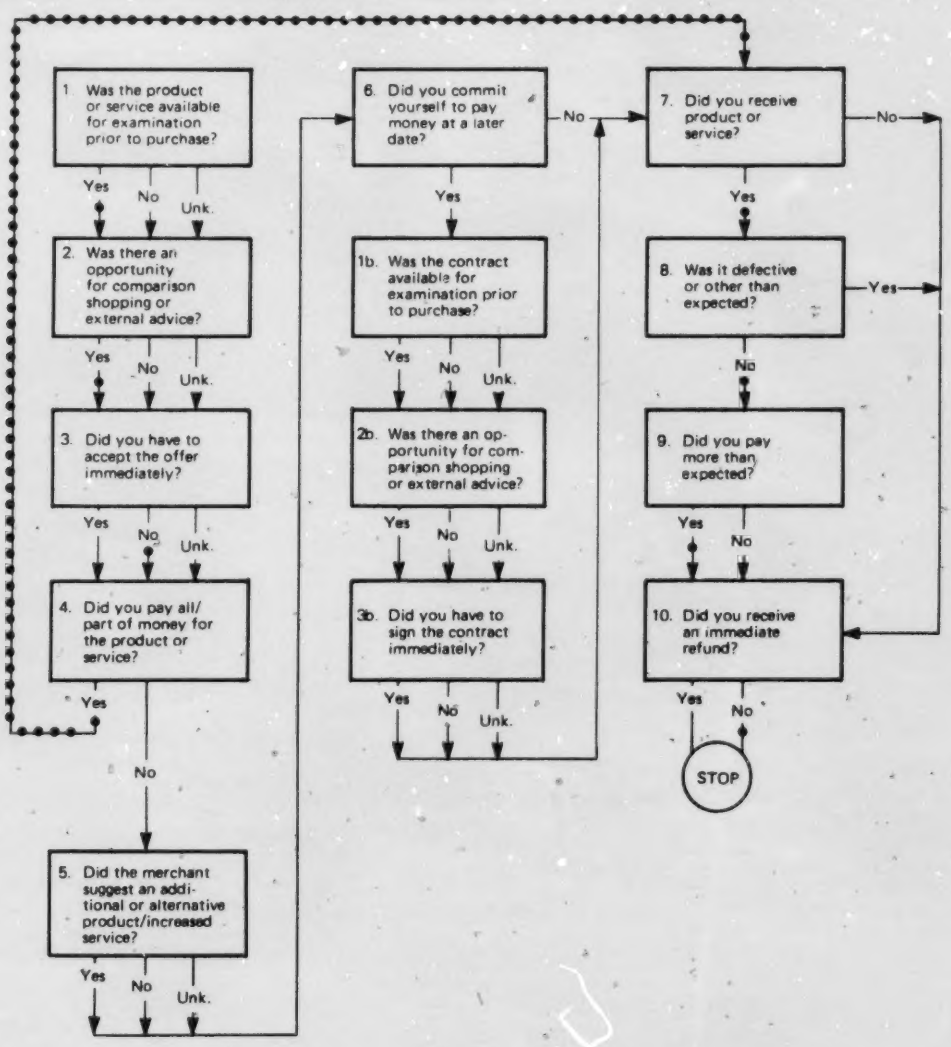
  Unavailability of products or service (—)
  Merchant misrepresented benefit(s) of product or service (+)
  Consumers reported receipt of poor quality products (+)
  Consumers reported receiving a product different from the one purchased (+)

- There were more reported cases of oral representation as the primary medium used to perpetrate the fraud than expected.
- The records revealed that there were more cases in which the source of the consumer complaint was unknown than expected.
- There were more cases in which the consumer sought relief for the reported grievance by exchanging the merchandise than expected.
- More consumers reported that merchants argued about 'product claims' when confronted with the complaint than expected.

Profile	7
No. of Cases	116
Percent of Total	10

The product or service was available prior to purchase, comparison shopping was not precluded, and the consumer did not have to accept the offer immediately. The consumer paid for all or most of the product or service at the time of purchase. A product or service was received that did match the consumer's expectations; however, the consumer paid more than anticipated. The consumer did not receive an immediate refund.

Network Analysis


1. Was the product or service available for examination prior to purchase?
Yes
No
Unk.
2. Was there an opportunity for comparison shopping or external advice?
3. Did you have to accept the offer immediately?
4. Did you pay all/part of money for the product or service?
5. Did the merchant suggest an additional or alternative product/increased service?
6. Did you commit yourself to pay money at a later date?
1b. Was the contract available for examination prior to purchase?
2b. Was there an opportunity for comparison shopping or external advice?
3b. Did you have to sign the contract immediately?
7. Did you receive product or service?
8. Was it defective or other than expected?
9. Did you pay more than expected?
10. Did you receive an immediate refund?
STOP

Descriptive Data

- The complaint of overcharging or charging hidden costs was overrepresented.
- The incidence of no money being involved in the transaction was overrepresented.
- The merchant response of arguing price claims was overrepresented.

The Measurement of Consumer Fraud. In our original proposal, we viewed the measurement problem as *"one of the most difficult issues to be resolved before consumer fraud can be attacked systematically".* We have *not* resolved the measurement issue, but we believe that fraud can be attacked systematically, nonetheless. How can this be?

As planned, we gave most of our attention to "hard" data consisting of reported instances of fraudulent events. We had been concerned that these data might "overrepresent offenses leading to the largest losses, affecting more articulate victims, and representing the emphasis of the agencies supplying the data." It must be true that our data sources, and all existing sources, overrepresent the better educated and more articulate consumer. Pursuing a complaint when satisfaction is not obtained from the merchant, requires the consumer to (a) know the avenues available, (b) have the time and resources to file and follow-up, and (c) believe that the expenditure of time and resources is worthwhile. Lower income and less educated consumers are disadvantaged in all three areas--they may not know where to file a complaint, they may be unable to take the time to file, and they will often believe that it won't do any good in any event. We are not concerned about bias in our selection of sources; our coverage was sufficiently broad to avoid the special emphasis that one agency might show. And our first concern--that we would get only the dramatic, large loss events--was not substantiated by the data. As noted elsewhere, our data are characterized by the apparent normalcy of the transactions described.

It is this last fact which reduces our concern with more precise measurement. We know that there is a very large and relatively homogeneous set of events which damage consumers. Whether our data sources reveal 20 or 50 percent of this mass seems relatively unimportant.

We were unable to estimate the magnitude of the unreported events which occur, because agencies do not routinely collect descriptive data which would permit estimates to be generated. We seldom know anything about the socio-economic status of the victim; the records are generally mute concerning age, type of household, income, and the like.

We were equally unsuccessful in discovering unobtrusive indicators of fraud. We made no investment, other than a search of the literature, in the attempt to identify such measures. We doubt seriously that any major effort is justified. Our one recommendation regarding measurement is to encourage the widespread adoption of a standard complaint form, with accompanying manual of instructions for completing the form. A very large scale data base could be created at relatively low cost through such a device.

1.4.3 PRODUCT

A technical report details the data collection procedures and data analysis. A large portion of the document is devoted to the profiles generated by the results. Extensive tabular data are included which show the frequency distributions of all variables, the data collection instrument and companion guide, comprehensive descriptions of the three classification schemes and cross-tabulations of all 40 variables by each of the 23 profiles.

1.5 Phase II: NCLC

1.5.1 GOALS

The primary task was to assess the status and application of existing consumer fraud legal sanctions by surveying law enforcement and criminal justice officials.

1.5.2 ACTIVITIES AND ACCOMPLISHMENTS

The survey of existing intervention strategies utilized both primary and secondary sources. Primary sources were 112 enforcement officials and consumer experts from four states* and the District of Columbia; these interviewees represented federal enforcement officers (26), state prosecutors, members of consumer protection boards, judges, and legislators (35), local district attorneys and consumer protection board members (25), and private attorneys, law professors, and others (26). The secondary sources were drawn from relevant literature - books, journals, legal publications, and the like.

Twenty-two illustrative and commonly used intervention strategies are disclosed in the findings; these 22 approaches are organized into seven overall categories of enforcement. The results describe the state-of-the-art in enforcement mechanisms and do not attempt to recommend any new strategies. Summaries of the findings are discussed on the following pages, according to the seven categories.

Deterrence employs the technique of putting sellers on notice that fraudulent conduct will be penalized; the threat of prosecution deters merchant misconduct. The effectiveness of this approach may be measured by sellers' response to the threat of such prosecution though no such data were uncovered. A deterrence program is cost-effective if a few prosecutions prevent most sellers from engaging in consumer fraud. Four strategies are suggested within the general mechanism of deterrence:

1. Criminal sentences. These are effective if the threat of prosecution and harsh sentencing is real enough to the merchant. The impact is greater on mainstream businesses than fly-by-night sellers. Criminal

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* California, Georgia, Massachusetts, and New York.

prosecutions are rare events for numerous reasons; when brought to court, long prison sentences seldom result.

2. Injunctions, cease and desist orders. This strategy attempts to deter the merchant being prosecuted from future frauds. Prosecution is eased by using civil procedures and more liberal standards of actionable merchant misconduct. Injunctive orders cannot be obtained easily or quickly; when obtained, the documents are quite narrow in scope and do not result in merchant compliance.

3. Fines, penalties, and license revocations. Implementation of such strategies requires simple standards and procedures to penalize sellers for initial violations, although "fines that hurt" are seldom used. License revocations, although harsher, are rarely imposed.

4. Private Attorneys General. Although theoretically an option, most consumers lack the incentive to serve as a private attorney general. It is not practical to consider private actions, independent of outside support.

Compensating victims provides an opportunity for the offending merchant to return the defrauded consumer to the status quo, redressing wrongs suffered. But, since no available strategy returns all defrauded consumers to the status quo, this approach must be viewed as a partial solution, compensating as many victims as possible. There are three important strategies utilizing this approach.

5. Private damage actions. Injured consumers can ask the court to order the offending seller to pay damages. Since traditional actions are not practical to redress small frauds, states have developed a number of innovations. Special damage awards, attorney fees, small claims courts, and class actions attempt to make fraud actions easier and cheaper to bring. While successful to some extent, all of these innovations have significant weaknesses.

6. Restitution. Government prosecutors can request a court to order restitution to all consumers defrauded by a seller. This strategy is similar to a private class action, sharing its strengths and weaknesses, but it also has advantages and disadvantages of its own.

7. Complaint mediation. This is a voluntary process of government agencies mediating disputes between sellers and buyers. Many defrauded consumers do not complain, agencies refuse to mediate certain complaints, and certain merchants refuse to participate. But for a large number of consumers, complaint mediation results in at least partial compensation.

Self-enforcing remedies allow consumers to redress or even deter fraud with little or no intervention from the judge, or mediator. Three strategies emanate from this approach:

8. Withhold payments. Consumers buying on credit refuse to pay the remaining amount due on fraudulent sales. This partially compensates the consumer and requires no affirmative action. Creditors utilize various techniques to discourage consumers withholding payment. Consumers who do default on their debts are ineffective in defending debt collection actions. But if they manage to retain an attorney, defrauded consumers are in a powerful position raising fraud defenses to the creditor's collection action.

9. Automatic remedies. Rejecting non-conforming goods, cancelling contracts, and retaining unsolicited goods are available and effective in certain contexts, but often rely on government action to insure that sellers comply with them.

10. Consumer demonstrations. This is the most self-enforcing remedy, using publicity to attack defrauding merchants. If the demonstration discourages business, the seller may negotiate. Legal and practical impediments prevent widespread use of this remedy.

Controlling seller behavior directly. Instead of compensating past victims or relying on a few prosecutions to deter fraud, the seller's conduct of his business is limited in certain ways. This approach entangles the government into sellers day to day business, increasing costs both to the regulated and the regulator, but its prophylactic nature may be superior to other approaches.

11. Licensing. This strategy restricts entry into occupations and controls licensed sellers' behavior. But existing licensing boards are often developed to reduce competition, not fraud. Industry domination and the lack of resources and enforcement authority limit their effectiveness.

12. Limit sales approaches and advertising practices. These specific regulations are rarely effective against fly-by-night sellers but, if drafted carefully, influence mainstream sellers. The more restrictive the regulation, the more effective and costly to legitimate businesses. Numerous obstacles to effective advertising monitoring makes it a questionable intervention strategy.

13. Controlling contract language. Contract terms often aid and abet fraud schemes. Substantive regulation of standard form contracts has clear advantages, but it is strongly opposed by business interests.

Improving consumer decision-making results in better consumer purchases, with fewer resulting in fraud. This approach has the advantage of interfering with seller decisions and practices only to the extent necessary to improve consumer purchase choices. The approach can be seen as just insuring that the free market operates properly.

14. Pre-sale disclosures. This strategy requires sellers to inform consumers of specific information before the purchase is finalized. Disclosures are designed to make consumer choices more effective, allowing buyers to avoid being defrauded. But merchants may not make ordered disclosures; if they do, it may be in a manner or in language that insures consumers will not read or understand them.

15. Cooling off, trial periods, and affirmation. This restructures the purchase decision to give consumers longer to ponder the sales transaction, and cancel with no financial obligation. These techniques assist some consumers, but others do not know how to use them or are frustrated by merchant devices nullifying the remedy's benefits.

16. Consumer education. These efforts provide information to help consumers avoid or remedy fraud. Government or private consumer agencies use a variety of techniques to try to meaningfully reach the public. The effectiveness of these efforts has not been adequately measured.

Minimizing fraud losses by restricting the amount of money at stake in the transaction is another approach. Even if the consumer is defrauded, the loss is small. Since the consumer injury is minimal, seller's profit and his consequent incentive to defraud is decreased. The survey reveals two strategies.

17. Price limitations. Refund standards and contract limitations can limit the cost of future service contracts for consumers who cancel early. This type of price regulation minimally impedes sellers while offering consumers protection against fraudulent sales.

18. Escrow. Such accounts do not limit a transaction's price but restrict the seller's receipt of payment until the consumer determines absence of fraud. A third party only makes payment to the merchant if the escrow agreement is satisfied; otherwise, the money is returned to the consumer. Effective use of escrow requires a clearcut method of determining which party should receive payment. It also restricts merchant's cash flow and increases administrative costs.

Third parties, such as creditors or insurance companies police merchants and/or bear fraud losses. Sometimes third

parties can perform these tasks better than consumers or even government enforcement agencies. However, third parties are also expert at avoiding this responsibility and turning it back over to consumers. We identified four candidates for positive action.

19. Limiting defense cut-offs. This strategy allows consumers to raise fraud defenses against third party creditors in debt collection actions. These creditors, facing losses due to the merchant's fraud, are encouraged to screen out potentially fraudulent sellers from credit arrangements or establish recourse arrangements that pass the fraud loss back to the seller.

20. Bankruptcy. This occurs when the defrauding seller has insufficient assets to pay off creditors and consumers. Present procedures result in consumers receiving nothing. Proposed reforms would shift some of these bankruptcy losses to creditors who are in a better position to evaluate sellers' solvency than consumers.

21. Hold corporate officials liable. This strategy calls for shifting the burden of policing a corporation's fraud to shareholders, directors, and officers of the corporation. But, in practice, this rarely happens. Both practical and legal factors immunize corporate officials. Even when they are found personally liable, liability insurance can further protect these officials.

22. Bonding and insurance. This shifts consumers' fraud losses to surety companies. These surety companies have a profit incentive to screen out and refuse bonds to potential fraud offenders, limiting their ability to continue in business. Unfortunately, the same profit incentive encourages bonding companies not to pay out on consumer claims. Other types of insurance schemes such as government run insurance pools and private, insured-funded insurance plans, have advantages over bonding in this regard, but have other drawbacks.

1.5.3 PRODUCT

A report on consumer fraud intervention strategies presents a detailed analysis of each of the 22 remedies.

This concludes the historical perspective and sets the stage for a blending of AIR and NCLC's findings during Phase I and Phase II. Our work had resulted in two major outcomes--effectiveness of intervention strategies currently practiced by many law enforcement agencies and consumer affairs offices throughout the United States, and 23 profiles of consumer abuse. Our next and final task was to use these products to pinpoint areas of significant need for intervention strategies and to assess the probable value of alternative remedies.

2. OPPORTUNITIES FOR INTERVENTION

The objective of Phase III, and the ultimate objective of the entire project, was to develop strategies which would be effective in combatting abuses of the types revealed in our data. The basic materials for this development consisted of

- the systematic descriptions of patterns of consumer abuse, and
- an analysis of current potential effectiveness of existing interventions,

both of which were products of the projects's second phase. The essential task was to conjoin these materials and to evaluate the adequacy of each intervention as a response to the patterns of abuse. There is no precise technology which supports tasks of this kind; reliance must be placed on a logical analysis of the apparent match or mismatch between a "problem" and a "solution." In order to make our reasoning open to public examination, AIR developed rationales which link each proposed intervention strategy to the problem area it is intended to remedy. In this report, these rationales appear in abbreviated form, but in sufficient detail to present the skeleton of each argument. Some will disagree with our reasoning; in dealing with complex issues, difference of opinion is both desirable and inevitable. Debate should be encouraged; our principal goal is to present our logical analysis with sufficient clarity to permit informed debate on the central issues of concern.

Before presenting the interventions which we believe to be worthy of consideration, two principles which influenced our selection should be made explicit. Both derive from the data on consumer abuse, but neither are *ordained* by those data. First, for this domain which is characterized by *a very large number of small losses*, we believe the court system to be of limited utility. It is an already overburdened system with elaborate rules or procedures which discourage its use by the individual consumer. We consider class actions and small claims proceedings among our interventions, but we have emphasized approaches which avoid the courts.

Second, we view the government role as that of *court of last resort*. Government should stimulate, persuade, influence and twist arms if necessary, to see that mechanisms for consumer protection are present and operating effectively. But the government should be the operator only as a last resort. Our recommendations for government action are governed by the least drastic

alternative principle. We assign to government only those functions which cannot be managed effectively by the individuals and institutions of the private sector.

We also wish to give some mention to intervention strategies which we rejected, indicating the bases for rejection.

First, we pay almost no attention to *criminal sentences, fines, and penalties*. Advocates of criminal sanctions believe that sentencing offenders may have a powerful deterrent effect on other merchants. They may well be correct. The absence of widely accepted and demonstrably adequate measures of deterrence for any area of criminal offense makes the point difficult to prove or refute. But our neglect of criminal sanctions does not stem from the conflicting views of its effects. We reject it because we do not believe that it can be applied seriously in the broad domain with which we are concerned. Hard core fraud schemers will be sent to prison whenever the evidence is sufficient to warrant a verdict of guilt. "Respectable" merchants generally will find the court merciful. The fines levied will seldom be punishing. The sequence is: few will be apprehended by any law enforcement agency, few of those apprehended will be prosecuted, few of these will be found guilty, and for the infinitesimal few who are so judged, suspended sentences, probation, and token fines are the norm. We see no signs that these realities are changing.*

We make no mention of *economic crime units* as a force against consumer abuse. We strongly endorse the Federal, state, and local support of such units and are very encouraged with their achievements and potential. They have had impact on auto-repair fraud in at least one city, and that model is clearly replicable.** But we believe that they will have very little impact on many of the types of consumer abuse which were frequent in our data. The sad truth is that such events are just not exciting enough to hold the attention of economic crime units. The events are pedestrian, the losses are numerous but small, and there are no interesting or challenging themes to unravel. Compared to computer-based fund transfers, large-scale embezzlement, political corruption, or even employee theft, consumer abuse is small potatoes. Economic crime units will concentrate on the big action.

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* This will strike some as an overstatement, and perhaps it is. Certainly there will be some highly publicized exceptions, where the full resources of the law encorcement community are brought to bear on a flagrant abuser. But the available resources are insufficient to provide across-the-board protection for all victims.

** In Philadelphia, AUTOTAP (an industry sponsored panel) provides an inspection service for consumers with automobile repair complaints. The service is explained more fully in the Phase II Report (NCLC), p. 57.

Consumer demonstrations and picketing are ignored. We have nothing sensible to say on these devices. They are extremely difficult to mount and maintain, and the results have seldom been satisfactory to the campaigners. Demonstrations may be useful as an education device, to call attention to some abuse or abuser. But we are unable to design a strategy based on demonstrations which we believe would be both implementable and effective.

We also say nothing about *bankruptcy actions by the consumer* as a mechanism to thwart collection of payments following a fraudulent transaction. This device is inexpensive, relatively simple, and extremely effective for the low-income consumer who has no assets worth protecting. But it is a basically negative approach which removes a symptom without touching the underlying problem. We favor instead, a strategy of creditor liability which attacks the problem directly.

We do not treat *consumer education* as an independent strategy, though we believe it to be the most powerful mechanism available in the long term. We view consumer education as an essential component of every strategy, not as an approach which can stand on its own. We would advocate thirty-second spots on television, tied to a particular type of transaction, or intervention, or consumer right. We would advocate educational materials, such as checklists, pamphlets, jobs aids, being available at the scene of a transaction. We advocate the widespread explanation--in simple English--of the real costs and benefits of alternative cans of peaches. Each of these educational efforts would support a specific strategy designed to control some specific pattern of fraud or abuse. Our data do not provide the ingredients for a generalized consumer education curriculum.

In the following section, we will present analyses of sixteen approaches, organized into six areas. The six are:

> Payment Planning. The purpose is to restructure payment procedures to allow the consumer leverage when the transaction turns sour. The four strategies suggested are new applications of existing mechanisms; each is focused on a transaction-in-progress.
>
> Post-Sale Alternatives. There are many occasions when a consumer legitimately reverses a decision to purchase a product or service and wants to back out, but the merchant refuses. Four options are offered for improving the situation by giving consumers the opportunity to exercise automatic cancellation rights: rejection of goods or revocations of acceptance; cooling-off periods following written agreement to a transaction; warranty rights that permit remedies following expiration of the cooling-off period or inapplicability of rejection; and refund standards useful for many future service contracts.

Complaint Mediation. The need that generated this recommendation is the lack of success experienced by consumers in attempting to seek redress for a grievance. Three types of change are considered: making the mediator more available; increasing the probability that merchants become involved in the mediation; and improving the quality of the actual mediation.

Private Remedies. Consumers have options for initiating proceedings against fraudulent merchants without involving a third party. Consumers often are unaware of these options. Furthermore, there are serious obstacles to their use at the present; they more often serve the merchant than the consumer. Modifications are recommended to redress this imbalance in small claims courts. Class action proceedings are also considered.

Coverage for Consumer Loss. Providing coverage for loss is the most general of the six areas; it is potentially applicable to any pattern of fraud. Strategies considered include bonding, insurance, creditor liability, and consumer priority in bankruptcy proceedings.

Document Simplification. This intervention is designed to produce a balance of knowledge between the merchant and the consumer in all transactions where print media are involved. The focus is on the pre-transaction period.

Each approach will be evaluated against a standard set of criteria. In terms of these criteria, an ideal strategy is one which:

Requires minimal investments by both merchant and consumer. Some existing mechanisms place an unreasonable burden on the consumer; hiring an attorney to recover a small dollar loss is one example But legislative and regulatory remedies may place equally unreasonable burdens on non-offending merchants. Escrow, for example, is an effective and powerful protective device for consumers. But its broad application in the marketplace would create untenable cash flow problems for many merchants.

Is easy to implement. An approach which requires legislation will find the road to implementation a long, poorly marked, and uncertain one, with many detours along its course. Producing an administrative guideline to implement an existing legislative mandate is easier. A consumer education effort faces still fewer obstacles to implementation.

Has low administrative and enforcement costs. An approach might require the creation of a new bureaucratic entity at state and/or federal level. Another might add a function to an existing unit. A third might substitute a new function for an existing

one, and thereby add little or no administrative expense. An approach might place an administrative burden on the private sector rather than on government. The criterion is the magnitude, not the location of the costs.

Has low susceptibility to abuse by consumers. For some programs, detection of abuse is relatively simple; for others it is very difficult. Some implementing guidelines almost "invite" attempts to abuse; others discourage such attempts by making their detection devices highly visible.

Does not adversely affect other interventions. Increased consumer protection which is offered as a "free good" will decrease consumer vigilance in the marketplace. Concurrent attempts to educate consumers will thereby be weakened. One-by-one approaches to our society's problems too often ignore these unintended effects.

Provides adequate scope. There are two issues here. The first concerns the adequacy of coverage for the population at risk. Some approaches "miss" the population most in need; the consumer education efforts of PBS have been criticized for this deficiency. Approaches also vary in their coverage of the market. Some are narrow in focus, applying to one segment such as auto repair; some cover all transactions which involve a specified mechanism, as door-to-door sales; others are still more general, applying to almost any transaction. We will refer to these two issues as Scope: General and Scope: Specific.

Has significant pay-off in reducing consumer loss. This is the bottom line in evaluating the effectiveness of an intervention. It transcends all other criteria. Truly significant pay-off might justify a program of relatively narrow scope.

2.1 Payment Planning

2.1.1 NATURE OF THE PROBLEM

The practice of requiring complete or partial payment prior to delivery of a product or service is widespread. Complete prepayment is typical in many mail order transactions. Partial payment is common for special-order and lay-away transactions. Many purchases of service transactions, as home repair contracts, call for a schedule of partial payments before, during, and upon completion of the service. In some transactions, incentives are offered for prepayment, such as lower item cost or elimination of handling or delivery charges. While most transactions involving prepayment are completed to consumer satisfaction, a very large number of abuses occur. In our data base,

- 16% of the cases involved prepayment, with no product or service ever being delivered, and
- 24% involved prepayment and receipt of goods or services which were defective, different from that ordered, or unsatisfactory in some way.

Prepayment necessarily offers a potential for abuse and, as the data indicate, the potential too often is realized.

2.1.2 ANALYSIS

Eliminating or severely restricting prepayments seems attractive from the consumer's view. There are two serious weaknesses from the seller's viewpoint. First, the merchant requires some evidence of the consumer's intent to purchase. If an order is placed with a manufacturer for a piece of furniture to meet customer specifications as to color, finish, upholstery, and the like, the merchant deserves assurance that the customer will complete the transaction when the furniture arrives. The partial prepayment is the merchant's insurance against consumer default. Without such payment, merchants would be highly susceptible to abuse by consumers. Second, there are occasions where the merchant must make some prepayment with his order; in these cases, payments from consumers may be an essential component of cash flow. If deprived of this component, higher prices due to commercial financing will be passed on to the consumer, making the small merchant less competitive.

Where the only issue is one of insuring against consumer default, escrow arrangements deserve serious consideration. Escrow has the potential for protecting both consumer and merchant. The Phase II (NCLC) report described a possible example of an escrow arrangement in a consumer context:

> A consumer may put mail order payment into an escrow account. The escrow agreement could specify that a bank will hold the money until the mail ordered good is delivered, at which point the payment automatically reverts to the seller. If the merchandise never arrives, the consumer gets his money back at some specified time. Both sides are protected if the bank, theoretically the agent of both parties, properly fulfills its function. The bank is liable if its acts improperly.

Escrow is seldom used in consumer transactions, but it is commonly applied in real estate closings, property tax payments or rent withholding from landlords. The report also states:

> Escrow, as a consumer fraud strategy, is currently limited to prepayments for air charters and travel services. Civil Aeronautics Board (CAB) regulations require passenger prepayments to air charter companies to be deposited in escrow with a bank. The air carrier receives payment only after the air charter flight has been completed. If the air carrier cancels the flight, the bank returns the escrowed funds directly to the passengers.
>
> This regulation was in response to extensive fraud in the charter industry when consumers were never returned their large deposits when flights were cancelled. Quebec Province has similar regulations requiring travel agencies to place in escrow prepayments for all travel services.

Escrow seems to be potentially applicable for many classes of transaction where it is not used at present. Mail order is one such class; special orders of furniture or other high dollar value items for another. It might be considered, with some qualifications, for long-term service contracts, such as are used by vocational schools, health spas, and dance studios.

Escrow arrangements could be created by private agreement or could be required by statute. While the former may be more desirable, consumer-initiated arrangements are unlikely to make any real headway. Most consumers lack the knowledge or negotiating skills to construct such arrangements. Even where consumers know about escrow, its scope of applicability may be very narrow. Escrow obviously reduces the working capital available to the merchant, and in some businesses, the reduction could have disastrous consequences. Escrow could always be *considered* in prepaid transactions, but it cannot be widely invoked in many sectors of the marketplace.

The same weaknesses will often apply to consumer attempts to negotiate a reduced prepayment. The merchant has more knowledge about the transaction and will often be able to convince the consumer of the necessity of prepayment. And, as with escrow, the need may literally be true. The merchant may be unable to place his order for merchandise without prepayment to the wholesaler or supplier.

Pay-as-you-go plans, which are commonly used in purchase of services transactions, are a special form of partial prepayment. Typically, a payment is made when the agreement is signed, one or more payments are made at specified points of service delivery, and a final payment is made when the work is completed. One form of abuse in our data base is work never completed. Presumably, the seller has realized his profit from the partial payments and leaves the consumer with a half-finished kitchen or added room.* This situation might also be remedied by a modified escrow arrangement. Some significant portion of each scheduled payment might be held in escrow until the work is completed. For any pay-as-you-go plan to be effective, there must be precise specifications of the final product and some number of intermediate stages, with explicit criteria for acceptance. These are as essential for an escrow plan as for an uncomplicated buyer-seller transaction.

In the absence of other options, a consumer can withhold payment to a merchant who has not delivered a satisfactory product. This simple act will usually *limit* rather than avoid loss, since a partial payment or deposit is not recovered. If the consumer has legal representation, the position is relatively strong; withholding payment is at least better than assuming a portion of powerlessness in the face of merchant or collection agency threats. By providing legal support, by assisting consumers in the preparation of their own defense, and by educating consumers about the legal limits of collection agency procedures, merchants may be deterred from further abusing consumers who have partially prepaid and not received satisfactory delivery.

2.1.3 EVALUATION

In Table 2.1 we evaluate four payment plan procedures on our standard set of criteria. Some comments on our evaluation follow.

2.1.3.1 *Burden on merchant and consumer.* In general, all approaches restrict the merchant's cash flow; whether the restriction is reasonable or unreasonable must be decided for each market sector. For mail order houses, for example, C.O.D. seems perfectly equitable; there is no obvious reason for requiring prepayment. Some prepayment may be essential for special orders; whether this can be escrowed depends on whether some form of prepayment is also required of the merchant (which could also be escrowed, of course). Escrow is the only approach which clearly affects the consumer's cash flow, though some pay-as-you-go and combinations of escrow and pay-as-you-go would accelerate the consumer's out-of-pocket schedule.

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* The inadequacy of most home repair contracts will be considered in a later intervention strategy which deals with document simplification.

Table 2.1 Payment Plans

	Limited prepayment requirements	Withholding the final payment	Escrow	Pay as you go
BURDEN — On merchant	High for some who depend on up-front cash flow	Minimal—especially where some profit already is realized	High—could restrict access to funds, until completion	Problems in collection and cash flow
BURDEN — On consumer	None	None	Moderate—high might require paying more at once	Moderate
EASE OF IMPLEMENTATION	Difficult; legislation probably necessary	Easy to effect	Difficult; legislation probably necessary	Relatively easy—need consumer education
ADMINISTRATIVE COSTS	Moderate; some regulatory enforcement	Minimal in most cases	Tolerable; third-party enforcement	Negligible
SUSCEPTIBILITY TO ABUSE	Could be abused by consumer	Could be abused by consumer	Minimal	Uncertain on both parties, probably low
INTERFACE WITH OTHER INTERVENTIONS	Supported by consumer education	Mutually supportive with mediation, education	Alternative to bonding, insurance, etc.	Supported by document simplification
SCOPE — General	Uncertain	Broad	Potentially very broad	Uncertain
SCOPE — Specific	Mail-order	No special area	Major product purchase	Home repairs, service contracts
PAY-OFF — Short-term	Significant	Minimal	Moderate to significant	Uncertain
PAY-OFF — Long-term	Significant	Minimal	Significant	Significant

2.1.3.2 *Ease of implementation.* It is difficult to judge the ease with which these changes could be implemented. Restricted prepayment and the expanded use of escrow go against well-entrenched business practice; it is difficult to imagine either becoming widespread without regulatory legislation. More effective pay-as-you-go plans depend on consumer education and the availability of standard, simplified contracts (see later section on document simplification).

2.1.3.3 *Administrative costs.* None of the approaches have intolerable costs. Since restricting or eliminating prepayment is relatively simple in concept, no elaborate enforcement mechanism would seem to be required.

2.1.3.4 *Susceptibility to abuse.* Merchants deserve protection also, and two of the approaches can be abused by consumers. If implemented, prepayment restrictions should be accompanied by mechanisms to protect the seller against frivolous ordering followed by nonacceptance.

2.1.3.5 *Interface with other intentions.* Education supports all four; pay-as-you-go dependent on document simplification for some applications.

2.1.3.6 *Scope: general and specific.* The entries require no added comment.

2.1.3.7 *Payoff.* Our estimates are extremely crude best guesses.

2.2 Post-Sale Alternatives

2.2.1 NATURE OF THE PROBLEM

There are many cases where the consumer has a legitimate basis for wishing to void a transaction to which he or she had agreed. The decision to request a return to pre-transaction status might result from

- the use of high pressure sales tactics which induced a hasty decision to buy, or
- delivered goods which are unsatisfactory and clearly not as represented, or
- oral representation by the salesman which differs from the terms of the written contract.

In each of these cases, the consumer goal is to nullify the agreement.

Merchant response to a cancellation request is very often negative. Our data show that 45 percent of the complainants sought relief in the form of a refund or exchange, but only 25 percent reported success. Sellers are reluctant to return money or cancel sales agreements. They argue that consumers waited too long to return a product or the amount of time and money invested in a service has been too great to refund any money.

There are many instances where cancellation is not justified. If the consumer has used a product to the extent that its value is diminished, then even partial refund seems unreasonable. If all contracted-for services have been received--ten dance lessons, for example--then no cancellation could be considered. But prompt cancellation is reasonable if the product is seriously deficient, or if no merchant damage would be produced by cancellation prior to delivery.

2.2.2 ANALYSIS

There are several existing post-sale alternatives that give consumers automatic cancellation rights. Each remedy applies to a different type of transaction or consumer problem.

2.2.2.1 *Rejection or revocation of acceptance.* Rejection or revocation of acceptance applies to the sale of all goods. Delivered goods may be rejected if they do not conform to the sales agreement and the seller is so notified. After rejection, the buyer must hold the goods with reasonable care awaiting the seller's disposition of them. Acceptance of goods by the buyer precludes rejection, but mere receipt is not acceptance. Acceptance occurs when the buyer, after a reasonable opportunity to inspect the goods, fails to object to them.

Accepted goods may be revoked when a substantial impairment of value is found. A buyer may revoke acceptance if the nonconformity was difficult to discover at the time of purchase or if the seller assured the buyer it was free of defects. The seller must be notified of the revocation as soon as the defect is discovered.

As noted in our Phase II (NCLC) Report, there are three factors which limit the remedy's effectiveness:

- usually some payment has been made, and the rejecting consumer must try to get his money back from the merchant.
- consumers rarely return goods immediately, and this retention signifies acceptance.
- consumers are generally unaware of their rights to reject or revoke acceptance.

2.2.2.2 *Cooling-off periods.* A remedy similar to rejection is the cooling-off period. A cooling-off period of three days is applicable to sales of goods or services in the home. Other cooling-off periods apply to the sale of particular products or to credit agreements giving the financer an interest in the consumer's home. Some real estate transactions may have longer periods--up to fifteen days--during which the buyer may cancel without penalty. Sellers must cancel sales agreements if they receive the consumer's written notice within the cooling-off period. The seller must return all monies accepted and cancel an indebtedness; the buyer must make the cancelled purchase available for return to the seller.

Cooling-off periods have several advantages: they allow consumers to re-think their purchase, consult friends, engage in comparative shopping, and re-study the contract; sales representations can be re-evaluated away from the salesperson's pressure tactics; and goods received can be compared against sales claims.

Consumers' ignorance of and failure to exercise their cooling-off rights is the most critical limitation to the remedy's effectiveness. Existing cancellation right disclosures are not read and understood. This is another instance where an existing remedy could be made more effective through document simplification.

2.2.2.3 *Warranties.* Warranty rights give consumers continuing remedies after cooling-off periods expire and rejection is no longer applicable. Sellers give *express* warranties by affirming a fact or making a promise that

becomes part of the bargain, whether orally or in writing. *Implied* warranties of merchantability in the sale of new and used goods are assumed by the consumer as an act of "good faith" by the merchant, although not clearly or openly expressed. Merchantability means that goods must pass without objection in the trade. The seller may create an implied warranty of fitness to meet a specific purpose mentioned by the consumer.

After the buyer notifies the seller of a breach of warranty, the buyer can seek damages for the difference between the value of the goods accepted and the value of the warranted goods. The buyer can also claim proximate and consequential damages.

As noted in our earlier report, one problem with warranties is that consumers are not aware of their warranty rights. Only 50% of first-year law students are able to comprehend standard warranty language. The typical consumer seldom even tries to read the warranties on products purchased. It cannot be certain that warranties written in "plain English" would be read. But simplification could guarantee that the warranty would be comprehended, if read.

Sellers generally give very limited express warranties and waive all implied warranties. This is perfectly legal under the UCC that sets out standards when warranties are given, but not whether they must be given. Virtually all major appliance and automobile warranties disclaim implied warranties or merchantability and fitness.

The major government response to merchant failure to offer product warranties has been to require disclosure of the limited nature of the warranty given. But, as noted above, warranty language deprives the disclosure rule of any real value.

2.2.2.4 *Refund standards.* In certain future service contracts, consumers can cancel the agreement and receive sizeable refunds. Future service contracts are unique because they can be marketed with almost equal ease as one long-term sale or as a series of separate, smaller transactions. The latter technique allows consumers to discover fraud early in the series of transactions and drop out. They pay only for services received and not for services to be rendered. Consumer financial loss is limited and merchants' incentive to defraud is consequently reduced.

Unless legislation mandates otherwise, a seller can choose the refund policy used in the sales agreement and include arrangements that could be determined unenforceable

in court. Certain legislation sets out specific refund standards for particular future service contracts. The most pro-consumer standard, called "pro rata", charges buyers only for that percentage of the service used. Less liberal standards charge consumers with large initial fees and higher percentages of the total cost.

Refund formulas can be effective interventions if known to the consumer. However, when consumers contract for the service, merchants may misrepresent the refund policy, discourage dropouts and demands for refunds. To implement refund rights, consumers must also take affirmative action cancelling their contracts.

2.2.3 EVALUATION

Our assessment of four approaches is shown in Table 2.2. Some comments on our evaluation follow.

Table 2.2 Post-sale Alternatives

	Rejection of Goods	Cooling-off Periods	Warranty Rights	Refund Standards
BURDEN — On merchant	Significant	Minimal	Moderate	Moderate
BURDEN — On consumer	Minimal	Minimal	Minimal if seller co-operates; significant if no cooperation	Minimal if seller co-operates; significant if no cooperation
EASE OF IMPLEMENTATION	Very difficult; requires legislation or administrative rulemaking	Moderately difficult	Difficult; requires legislation	Difficult; requires FTC rulemaking, legislation
ADMINISTRATIVE COSTS	Uncertain	Acceptable	Negligible	Acceptable
SUSCEPTIBILITY TO ABUSE	Can be abused by consumer	Acceptable within limited scope	Acceptable	Acceptable
INTERFACE WITH OTHER INTERVENTIONS	Facilitated by complaint mediation	Facilitates private remedies and mediation; requires consumer education	Facilitates private remedies and complaint mediation; requires document simplification	Consumer education essential; mediation important
SCOPE — General	Narrow at first; eventually, impacts sale of all goods	Limited	Very broad	Broad
SCOPE — Specific	Products of highly visible criteria of quality	Real estate, other large purchases plus door-to-door	Appliances and major products	Future service contracts
PAY-OFF — Short-term	Significant	Significant	Significant	Significant
PAY-OFF — Long-term	Significant	Significant	Very significant	Significant

2.2.3.1 *Burden on merchant and consumer.* None of these approaches place unreasonable burdens on an honest merchant. If consumers abuse their "right" to reject by using irrelevant criteria, then the merchant is harmed. Explicit criteria (quality not as advertised) for rejection are essential to avoid this burden on the merchant. None place unreasonable burdens on the consumer.

2.2.3.2 *Ease of implementation.* None are easy; legislation or regulatory action seems necessary for any real impact. Local or state licensing authorities might implement cooling-off periods and refund standards in some sectors.

2.2.3.3 *Administrative costs.* None of the approaches have significant administrative requirements.

2.2.3.4 *Susceptibility to abuse.* As noted previously, rejection rights can be abused; the other three are relatively immune *if applied properly.* The reason that both rejection and cooling-off must be restricted in scope is that both offer opportunities for abuse. Records can be copied and books can be read in a very short period of time; clothing can be worn once and then returned. These post-sale alternatives could be expanded in scope only if merchant safeguards could be devised.

2.2.3.5 *Interface with other interventions.* All of these approaches would be facilitated by the availability of mediation services (see next section). The requirement for simplified warranties was noted earlier. Consumer education would supplement all approaches.

2.2.3.6 *Scope; general and specific.* Covered above.

2.2.3.7 *Pay-off.* Over the long term, warranties seem to us to promise the greatest pay-off. But all four could significantly reduce abuse.

2.3 Complaint Conciliation and Mediation

2.3.1 NATURE OF THE PROBLEM

When a consumer is not satisfied with the result of a transaction, the first appeal is to the merchant; this route is essentially (appropriately) universal. When this appeal is finally viewed as terminally unsuccessful, the next appeal is often directed to a consumer affairs agency or a complaint-handling office such as Action Line. When this service fails, the consumer has two choices - to live with the loss or to turn over the case to a private attorney and initiate formal adjudicative procedures.

It is probable that the first appeal is successful in the vast majority of cases; there is nothing in our data which suggests that most merchants are not honorable and responsible.* But our concern is with those who are not responsive to a consumer grievance, thereby forcing the "hurt" consumer to seek assistance from a third party. Our data show that the merchant's initial reaction to contact from a consumer following the transaction was negative in a large proportion of the cases--merchants responded by ignoring the consumer's contact (15%), skipping out (9%), arguing product claims (10%), or delays in taking action (13%). Our data also show that of 1,147 cases where a third party became involved, some relief was obtained in 458 (40%) situations when the merchant was available.** This is a conservative estimate, since some of the remaining cases had unknown outcomes. The important point is that the mediating agency made a difference and was apparently able to settle a disagreement between a merchant and a consumer which the two parties were unable to settle themselves. It appears that mediation, as a consumer tactic, is a sensible and often successful approach to correcting abuses.

Mediation is particularly appropriate for many types of abuses in our data set, those characterized by a large number of small losses. Systematic attempts to reduce such losses are badly needed, and mediation is a promising opportunity for corrective action. It is attractive because it is one of the least expensive alternatives for the consumer. It's chief weakness is that settlements are non-binding; but movement toward binding arbitration or more formal judicial proceedings involves far higher stakes. We recommend mediation as a mechanism which "fits" a very broad range of problems.

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* Because our data sources are agencies that receive consumer complaints, successes as a consequence of the first appeal are not reported.

** This excluded cases where the merchant skipped out, declared bankruptcy or disclaimed knowledge of the transaction.

2.3.2 ANALYSIS

There are some very basic reasons why the general intervention strategy of complaint mediation merits exploration. Initially, we will consider a prototypical complaint mediation procedure as any mechanism that attempts to resolve a consumer-merchant dispute without recourse to binding arbitration or judicial resolution. Such mechanisms have as one fundamental purpose the bringing together of the two parties or, more prosaically, to implement the fundamental rights of victims to confront their offenders and of alleged offenders to confront their accusers. A second fundamental purpose is to act as a neutral communication channel and filter (or translator) in situations of honest misunderstanding; for example, when there is a language barrier between the merchant and the consumer. Thus, for nonfraudulent transactions, some form of conciliation or mediation is a necessary component of an "ideal" marketplace.

On a less utopian level, formal complaint mechanisms can and do serve utilitarian functions in cases of potential or unrealized fraud. Defrauding sellers are typically willing to compensate a few complaining consumers so as to minimize the risk of adverse publicity or investigation. Similarly, many frauds depend on noncomplaint by the consumer, such as short-weighting or failure to perform agreed-to auto repairs. In these cases, the merchant, if confronted with the "evidence," typically "confesses" to an honest mistake and corrects the deficit; however, for all the consumers who don't complain, the merchant shows a profit. This fraud technique would suffer if consumers found it easier to complain.

Existing complaint mediation services suffer from several shortcomings. The first set of problems concerns the theoretical rationale for mediation; the second set identifies practical limitations associated with current implementations.

- mediation lacks a deterrent effect (since providing some complaining consumers with partial restitution does not penalize merchant misconduct);
- mediation's effectiveness is limited to the small minority of consumers who actually complain;
- mediation is a coverup for the Government's inability to prevent consumer abuse; and
- mediators have no authority to make their settlement recommendation binding on sellers, who can just respond "take me to court." Mediators generally cannot go to court on behalf of consumers and, if they can, they will not do so for small claims.

With respect to implementation, the following practical shortcomings are noted:

- many defrauded consumers never contact complaint mediation agencies. Low income consumers in particular have limited knowledge and even more limited use of available community resources.

- consumers fail to complain because of ignorance of available remedies, inertia, the small amount at stake, distrust of Government, feelings of powerlessness, embarrassment at being duped, and failure to discover frauds.

According to an unpublished study done by the Center for the Study of Responsive Law, the following criteria are necessary for the effectiveness of complaint mediation mechanisms:

- the mediation service or mediators must be visible to the consumer.

- they must be accessible to consumers in terms of ease of entry, cost, availability and convenience, and language.

- they must see that both sides to a dispute are directly involved in the resolution process.

- they must insure that the results of dispute settlement efforts are actually carried out.

- they must keep the consumer informed as to the status of the case.

- they must provide useful information on other avenues of redress, should dispute settlement efforts fail.

These criteria closely parallel the existing weaknesses listed earlier. In general, our three recommendations are based on these considerations. Although each of the suggested recommendations is necessary for a successful mediation program, they will be discussed separately in terms of the rationale for selection.

The first proposes an *increase in the availability of a mediation service*. Access is a problem for many consumers who may be aware of mediation agencies but are unable to benefit from their services. The obvious solution is to bring the service to the consumer. One way to accomplish this is by opening agency outlets at many locations - for example, assign representatives to shopping malls or central business districts. Another method is to establish an "outreach" program similar to the one implemented by the San Francisco District Attorney's Office. A complaint mobile visits urban neighborhoods on a rotating basis to explain the office function and collect complaints from consumers. Neighborhood Justice Centers provide another example of attempts to serve the consumer. Informing consumers about the location and phone number of a mediation service could be done by printing such data on sales receipts or on a warranty. Why not require merchants to prominently display such information?

For those consumers who do not know about mediation services, increased visibility may be had through a myriad of consumer education spots - public service advertising, newspaper and other publicity through the printed media, or channeling information through special school programs.

The second category of changes aims to *increase the participation of merchants in the mediation process.* Implementation is dependent on types and amounts of leverage that can be applied to merchants. One form could be through industry-wide policies that link licensing to merchant participation in disputes. One illustration of this is the Ford Consumer Appeals Board which consists of a five-member panel (two industry and three consumer representatives) who serve voluntarily to mediate consumer-dealer disputes. Panel decisions are binding on the dealer. Another way to encourage merchant involvement in dispute settlement is to create organizations of businesses who are geographically proximate - such as a shopping mall. Merchant-based sponsorship of mediation panels could foster participation as a result of social pressure or at a cost (requirement) of doing business at a particular location. Pressure can also be brought to bear on merchants as a result of demonstrations, picketing, and other adverse publicity.

The third type of recommended change emphasizes the *qualitative improvement of the mediation.* The idea is to staff the mediation board with impartial experts in the topics under dispute - skilled mechanics for auto repair problems, builders for home improvement disputes, and so forth. The major issue will probably be the source of financial reimbursement for these consultants. Another aid in improving the quality of mediation is to improve the "clarity" of the disputes. Defining each side's position can be helped through the implementation of clearer statements of product and service claims, better written warranties, and unambiguous performance contracts. Other subsidiary benefits may also be gained through improvements in pre-sale disclosures, cancellation rights, and related topics.

2.3.3 EVALUATION

Our assessment of the three recommendations is shown in Table 2.3. Some comments on our evaluation follow.

2.3.3.1 *Burden on the merchant and consumer.* If the merchant accepts the responsibility for informing the public about mediation services, uses business time to participate in mediation, and contributes to a fund that offers retainers to expert consultants, then the level of investment could be significant. Establishing mediation centers in shopping malls places a burden on the merchant. But if a consumer agency or a law enforcement agency supports such efforts - such as setting up mini-offices or servicing neighborhoods with a mobile unit - the burden on the merchant is negligible.

Table 2.3 Complaint Mediation

	Increasing availability and visibility	Increasing merchant involvement	Improving actual mediation
BURDEN — On merchant	Depends on sponsor	Potentially high	Possibly high if merchant involved
BURDEN — On consumer	None	Variable	Possibly high
EASE OF IMPLEMENTATION	Depends on resources	Potentially difficult	Difficult
ADMINISTRATIVE COSTS	Possibly high	Possibly high	Possibly high
SUSCEPTIBILITY TO ABUSE	Low	Very low	Very low
INTERFACE WITH OTHER INTERVENTIONS	Supports all strategies	Potentially non-supportive	Supports all strategies
SCOPE — General	Broad	Broad	Broad
SCOPE — Specific	Any transactions directly involving merchant and consumer	Any transactions directly involving merchant and consumer	Any transactions directly involving merchant and consumer
PAY-OFF — Short-term	Significant	Significant	Significant
PAY-OFF — Long-term	Significant	Significant	Significant

Using the public media for reporting on the availability of mediation services and illustrating with examples of cases does not require a heavy burden on the honest merchant. Perpetrators of abuse will be harmed if their questionable business practices are publicized. They could also be burdened if forced to mediate because of adopted industry standards.

The consumer is not unreasonably burdened considering the potential gain; the level of investment required will be to present accurate documentation of the transaction, if mediation services are desired.

2.3.3.2 *Ease of implementation.* This is difficult to judge except in response to a specific plan. To a large extent, it depends on who pays the bills. Merchants can use inexpensive techniques to educate consumers about the availability of mediation services, but they may be reluctant to become involved in any activity that interrupts the

conduct of business. The honest merchants have only a limited amount of time to spend away from the business; dishonest merchants have nothing to gain by participating in mediation, unless they give in to demands made early in the process just to relieve the pressure.

2.3.3.3 *Administrative costs.* The magnitude of such costs could be high if industry-wide standards are adopted and mechanisms for implementation are developed at a high level. Costs could be lowered, however, if local business groups, such as the Chamber of Commerce, organized a program within its sphere of influence.

2.3.3.4 *Susceptibility to abuse.* The nature of this recommendation lends itself to a potential for abuse, because the "false alarm" rate will rise with the "hit rate," at least in the beginning. We believe that, having tested the system, consumers will be unwilling to intentionally misrepresent complaints. The pay-off will be too low. It is difficult to imagine situations in which the merchant would publicly try to misuse the mediation process.

2.3.3.5 *Interface with other interventions.* Supportive of all other strategies. Theoretically, if the others are effective, it could reduce the incidence of mediations. A possible by-product of increased pressure to mediate would be for the merchant to resist implementing other interventions. Consumer education supports each recommendation.

2.3.3.6 *Scope: general and specific.* Broad on all counts. Any transaction that involves personal interaction between a merchant and a consumer falls within this sphere. The obvious nonapplicables are mail order transactions and door-to-door sales with itinerant merchants.

2.3.3.7 *Payoff.* Short-term payoffs on the visibility dimension should be immediate because consumer awareness about available help would be heightened; mechanisms in place are ready to serve the consumer. As many commentators have suggested, consumers do not know where to turn after an unsatisfactory business transaction, the long-term payoff is very significant because of the need for such a strategy. It is always possible that the abusers will learn the mediation system and develop new techniques to "beat the game."

2.4 Private Remedies

2.4.1 NATURE OF THE PROBLEM

The problem is identical to that discussed in the two preceding sections: a transaction has occurred and the consumer is not satisfied with the outcome. If the problem has not been resolved through mediation or through the post-sale alternatives discussed, the consumer might consider private action.

2.4.2 ANALYSIS

The responsibility for initiating court action against a merchant rests with the consumer. From his or her point of view, the strategy is effective if the proceedings are inexpensive, efficient, and money is recovered. In actual practice, none of the above takes place, so a promising mechanism for recovery of consumer loss is not used. The reasons for this are that:

- consumers are unaware that court action is an option without the aid of an attorney,
- consumers who try to use the courts without legal counsel are overwhelmed with completing court forms, procedural requirements, burden of proof, and other legal complexities,
- consumers who try to hire an attorney learn that it is economically feasible only in cases where damages amount to thousands of dollars because counsel's retainer will often be a minimum of $500 or a big chunk of the recovery,
- court proceedings typically involve long delays in obtaining trial dates; such delays are often synonomous with losing the case, and
- proof problems may be insurmountable because the merchandise may be too old to be of evidentiary value or consumer cases may rest on their version of a merchant's oral representations.

Two possible remedies exist for consumers to obtain relief through private damage actions against merchants accused of fraudulent behaviors. They are small claims courts and class action suits. Each will be treated individually.

2.4.2.1 *Small claims courts.* This mechanism is characterized as an accessible, inexpensive, high turnover forum employing informal and uncomplicated procedures. A chief criterion for use is court access to the merchant's assets, thereby negating the court's effectiveness to remedy frauds by insolvent or "fly-by-night" merchants. Consumers who attempt to use small claims courts in their present form will face many obstacles, such as:

- lack of accessibility. These courts are sometimes difficult to find--locating a telephone listing for the court may be an intellectual challenge,

- laborious court forms. Drafting a complaint to initiate court action can bewilder many consumers,

- imbalance of legal representation. Even though one advantage of the court is that consumers may appear without legal counsel, merchants rely on experienced legal representation.

- proving the existence of fraud. The burden of proof rests with the consumer, who usually lacks the expertise or the necessary resources to properly present evidence to support the allegations,

- constraints imposed by jurisdictional maximums. One cannot claim more than the jurisdictional maximum allows (average range from $500 - 750),

- difficulty in collecting judgments. Even if the court rules in the consumer's favor, a merchant can ignore the judgment. Enforcement of the decision rests with the consumer who will require the services of an attorney to apply for the enforcement so the money will be collected,

- no deterrent effect. Even if the merchant loses a case in small claims court, nothing is done to prevent future defrauding behaviors. These courts not only do not punish defrauding merchants, they do not share the outcomes of the suits with enforcement agencies who are empowered to restrict violations.

2.4.2.2 *Class action suits.* An alternative to consumers bringing individual actions in small claims court is the class action device. Theoretically, class actions are well-suited for securing wide-scale redress for consumer fraud. They adjudicate numerous claims and provide widespread compensation in one action without class members' active involvement. Combining numbers and resources allows class members to counteract the imbalance in financial resources between a business defendant and an individual consumer.

Despite the implicit promise, substantive, procedural, and practical impediments limit the full utilization and effectiveness of the class action device, resulting in rare instances of suits against certain types of consumer fraud and absence of widespread use against any specific type. Reasons are that:

- attorneys are reluctant to file class actions. The suits represent too substantial a level of investment for cases where payment is based on a contingency fee,

- there is judicial hostility to class actions. Judges are unfamiliar with class action procedure; they view class actions as gluts on their calendar,

- the court must find that questions common to the class "predominate" over questions of an individual nature. Evidence of misrepresentation and reliance by one class member does not prove those facts for other class members,

- a class action must be "manageable." The calculation and distribution of damages to consumer class members often require too much court time to make them manageable,

- inflexible notice requirements impede consumer damage class actions. Federal Rule 23 mandates that all class members who can be identified through reasonable efforts must receive individual notices. Plaintiffs must pay this significant cost during the litigation.

Despite these problems, there is hope for the utility of private damage actions as an effective mechanism for assisting consumers in recovering their losses. Our analysis of the existing weaknesses suggests some ideas for reforms, which, if applied, may permit private damage actions to function as agents of the consumer, rather than the merchant. These ideas are keyed to the major points addressed in the analysis section. In small claims courts, we recommend that actions be taken to:

1. increase awareness of small claims courts. Publicize their existence; increase the opportunities to find listings in telephone books,

2. increase accessibility to these courts. Move the courts from government buildings to less foreboding structures such as neighborhood centers,

3. facilitate the tasks related to filing a complaint. Redesign court forms to increase consumer comprehensibility and ease in filling out the documents,

4. increase types of actions that can be introduced in small claims courts. One way to achieve this is by amending existing deceptive trade practice statutes or "mini-FTC" acts,

5. strengthen the judgment power of the courts. Enable consumers to collect refunds decreed by the judgments by instituting follow-up procedures to determine whether or not the judgments have been paid,

6. devise mechanisms to interact with law enforcement agencies. One method would be to establish record-keeping procedures as standard practice in small claims courts.

For class actions, we suggest actions that:

7. shift burdens of proof from the class of consumers to the defendant,

8. adopt flexibility in calculating and distributing damages. The total damage to the class may be determined by examining the merchant's records; courts can then be authorized to calculate damages on a class-wide basis. Such a change requires legislative action, and

9. allow the award of minimal statutory damages for specific law violations. The potential deterrance to a defrauding merchant is significant if the class action must demonstrate a *violation of the law* rather than misrepresentation to each class member. Merchant violations affect all class members in some way so statutory damages may be awarded to each. No proof of actual damages is necessary for statutory awards.

2.4.3 EVALUATION

Our assessment of these private remedies is shown in Table 2.4, with some explanatory comments appended.

Table 2.4 Private Remedies

	Small Claims Court	Class Actions
BURDEN — On merchant	Acceptable	Acceptable
BURDEN — On consumer	Significant, but small compared to traditional private remedies	Minimal
EASE OF IMPLEMENTATION	Relatively easy; primarily internal reform by small claims court	Difficult; requires internal reform by supreme courts, trial courts, some new legislation
ADMINISTRATIVE COSTS	Moderate if expanded	Acceptable
SUSCEPTIBILITY TO ABUSE	Minimal	Minimal
INTERFACE WITH OTHER INTERVENTIONS	Facilitates private enforcement of other interventions	Facilitates private enforcement of other interventions
SCOPE — General	Broad	Very broad
SCOPE — Specific	Dollar limit	Any widespread abuse
PAY-OFF — Short-term	Significant	Significant
PAY-OFF — Long-term	Significant	Very significant

2.4.3.1 *Burden on the merchant.* Neither approach is burdensome to the reputable merchant. Any private action is a burden on the plaintiff; the class action minimizes the burden for most members of the class.

2.4.3.2 *Ease of implementation.* As noted, the recommended reforms to increase the usefulness of class actions as a consumer response require considerable judicial and/or legislative action.

2.4.3.3 *On all other criteria,* the approaches are very strong.

2.5 Coverage for Consumer Loss

2.5.1 NATURE OF THE PROBLEM

Most consumers who report a loss attributable to a merchant action, are not reimbursed for that loss. For the minority who are reimbursed, recovery is usually limited to the amount already paid for a defective or non-delivered product or service. Recovery for the indirect loss of time, effort and money spent in obtaining reimbursement is very rare. The evidence for these assertions is clear and compelling. In our data base,

- 68% of the consumers received no refund of any kind,
- only 5% recovered any portion of their *indirect* loss.

These data refer to consumers who took some action beyond appeal to the merchant. While fraud prevention strategies may reduce the amount of consumer loss, we must expect that there will be an appreciable number of losers throughout the foreseeable future. Provisions should therefore be made to provide coverage for the victim.

2.5.2 ANALYSIS

Any mechanism which would reimburse consumers for loss due to fraudulent transactions is potentially applicable to *all* patterns of fraud. Unlike approaches which attempt to prevent or deter the occurrence of a particular type or pattern of fraud, a *coverage* rationale is perfectly general. The intent of coverage is *to return the consumer to the state of affairs which prevailed before the transaction occurred,* for those cases where this outcome is not produced by voluntary merchant action.

There are existing mechanisms for third-party coverage of loss. Most were designed to protect merchants and institutions rather than consumers. An example is *bonding*. As was noted in the Phase II (NCLC) report,

> The major problem with bonding is that consumers find it difficult to collect on the bond. If consumers never collect, surety companies will not screen or police for fraud. Surety companies have a financial incentive not to pay on bonds. They are not competing to satisfy consumers, but to offer merchants low rates. Consequently, the fewer bonds they pay out, the more business they will attract.
>
> High risk sellers, unable to purchase bonds from major surety companies, turn to companies specializing in the residual market. These surety companies have unusually high losses and only stay in business by being tough on paying claims. Present bonding legislation does not provide consumers with penalties for surety companies' delay or improper refusal to pay.

Despite the weaknesses in current bonding practice, there is nothing intrinsically wrong with the *concept*. A consumer-oriented bonding strategy could be designed which would insure prompt payment to consumers victimized by merchants, would deny bonds--or price them beyond reach--to merchants with a record of fraudulent conduct, and could, if coupled with an effective consumer education effort, drive unscrupulous merchants from the field.

An alternative to bonding is an *insurance* approach, financed directly by the consumer or indirectly through merchant payments into an insurance pool. In the latter case, the pool might be created by trade associations or groups of merchants voluntarily, or participation might be required by legislation. There are existing examples of each. In Canada, travel agencies are required to maintain such a pool; some states have mandated similar pools to protect consumers from bankrupt money order and insurance companies. In Baltimore, furniture dealers have created an escrow pool to protect consumers against business failure by one of the members. And one could imagine a very broad-based insurance program analogous to the Federal Deposit Insurance Corporation.

Insurance schemes might also be financed by consumer-paid premiums. As in the previous case, the risk of loss is distributed over a large number of consumers; competition among insurance companies would result in adequate procedures for settling claims. An additional advantage would be the capability of the insurance companies to collect damages from offending sellers. An insurance company can maintain a staff of attorneys and other specialists who can become expert in collecting from offending merchants. If the market for such insurance were sufficiently large, an insurance company would have an incentive to police the marketplace, to seek special damage awards on behalf of its policyholders, and to thereby reduce its own losses and the rates which it could offer to its customers.

Should an insurance company decide to develop this potential market, initial costs to consumers might be quite high. If the company's total program were truly effective, the costs would be driven down and brought within reach of a larger number of consumers. But one can hardly imagine low income individuals purchasing consumer protection insurance.

A third mechanism, which currently operates to the consumer's *disadvantage*, could with modification, offer third party protection for consumers. Creditors of offending merchants are largely insulated from consumer fraud claims arising from transactions which the creditor finances. These defense cut-offs prevent consumers from raising fraud defenses in creditor collection actions. To obtain relief from the collection action, the consumer must bring an affirmative fraud action against the merchant. The contest is very unequal.

In our Phase II (NCLC) report, we considered the effect of modifying the holder-in-due-course doctrine and waiver of defense clauses. We noted that,

> Eliminating defense cut-offs does more than facilitate consumers withholding payments. Creditors subject to fraud defenses, have an incentive to screen and police merchants with whom they do business, minimizing their losses due to fraud defenses. Creditors who do not screen out fraudulent merchants are at a competitive disadvantage and will lose their market share to financers that do. More and more credit is extended only to sellers with low potentials for fraud.
>
> Regulation of any defense cut-off device meets the same industry criticism as the FTC's Holder-in-Due-Course Rule faced, that the supply of credit would be limited and its cost raised. But several cross-sectional econometric studies have found no statistically significant relationships between state restrictions of the HDC doctrine and the supply or cost of credit. The FTC's HDC Rule caused no significant decline in the availability of credit in such industries as mobile home, home improvements, and automobile sales.

A fourth mechanism is potentially available through merchant bankruptcy proceedings. Consumers will have little chance to recover losses from bankrupt merchants unless their status as a creditor is improved. Two changes are necessary: consumers must rank high among those who claim the bankrupt's remaining assets and they must be assured of receiving their award.

The prioritizing of creditors typically determines who carries the burden of the fraud. Law enforcement officials argue that creditors are not only in a better position to bear the loss, but can more effectively police defrauding merchants. The Massachusetts Attorney General notes three differences between consumer and merchant creditors that justify giving consumers priority:

- the consumer never intended to become a creditor, and did not suppose that the transaction involved risk,
- merchant creditors have received some compensation for their risk through interest or other concessions; no concession was granted to the consumer for advance payment, and
- the merchant creditor has far greater bargaining power, and has probably negotiated with the debtor prior to insolvency.

All of these approaches--bonding, insurance, creditor liability, and bankruptcy reform--deserve further consideration.

Because insurance is a traditional approach to distributing risk over a large population, and because FDIC was mentioned as a possible model, further comment on the nature of merchant-financed insurance seems desirable. Concerning FDIC, two comments summarize our view. First, all things considered, FDIC has worked very well indeed. It has not developed a massive bureaucracy; it has not drowned its members in a sea of paper; despite dire predictions to the contrary, banks have prospered. While the costs of FDIC are necessarily passed through to depositors in the form of lower interest rates than they might, in theory, receive otherwise, the effect on the individual depositor is miniscule. And the protection against loss of principal and accrued interest has been absolute; depositors in banks which failed have recovered all assets. Second, we could recommend a Federal Consumer Insurance Corporation only if all less drastic interventions failed. Here as elsewhere, government is seen as court of last resort. At the one extreme, any trade association might establish an insurance pool and require participation of its members. The National Canner's Association has an insurance program for its members. Its purpose is to protect canners from damage claims arising from consumers of defective canned goods. But since it does settle such claims, it obviously provides coverage for consumers. For any such program to be both effective and feasible as a consumer protection device, three conditions must exist.

First, the association must be able to enforce standards. If a cannery is in violation of industry-accepted standards of sanitation, then some enforceable action must be taken to protect other canners from the increased premiums that would result from increased claims. Second, if the only available action is to expel the offender from the association, then there must be some powerful reasons for maintaining membership. And third, if there are members and non-members participating in the market, consumers must know which are which, and avoid dealing with the non-members. These conditions are extremely difficult to bring about by total reliance on self-policing by a trade association.

The least drastic intervention by government is to provide the enforcement mechanism, while leaving the establishment of standards and the provision of insurance to the industry or trade association. The simplest mechanism is for government to make the industry-accepted standards a requirement for licensing. If a member is expelled by the association for violating standards, then the license would be revoked automatically.

Restricting the government role to the licensing function will often be inadequate as a consumer protection device. The licenser becomes known as a "captive of the industry", and this phrase is doubtless an accurate one for some "regulated" areas of the market. But the approach should not be excluded from consideration. In an ultimate and only partly Utopian sense, what is best for the consumer is also best for the honest, competitive merchant. But because self-policing has often failed to provide adequate protection to the consumer, intervention by government has often proceeded to the next step.

In this approach, the government establishes the standards, assumes the inspection (policing) role, and enforces through licensing. An industry-supported and managed insurance program could be required of all licensees. This model obviously requires a larger staff in the licensing agency than does the less drastic intervention model. It is not obvious that this represents a net increase in cost. For any standards-enforcing program, inspection (and inspectors) is essential; in the self-policing scheme, the inspectors would presumably be hired by the association or by its insurer. Despite opinion, there is no real evidence that efficiency is greater in the private sector than in government.

The most drastic intervention would be creation by the government of a Federal Consumer Insurance Corporation, as a public or quasi-public agency. Such an agency might deal with one market sector only (automobile dealers, for example) with several related sectors (automobile repair and service, appliance repair and service, and TV repair and service, for example) or it might be established as an umbrella, which could grow in scope by adding areas of the market over time.

The four options described above may be restated briefly as:

- no government intervention; private sector establishes standards, enforces compliance, provides insurance,
- government assumes enforcement responsibility through licensing; standards and insurance remain in private sector,
- government adds establishment of standards to responsibilities; private sector responsible for insurance,
- government assumes responsibility for standards, compliance and is the insurer.

We believe that these options should be pursued *in the order given*. The government's role should be to encourage the development of consumer-protective insurance programs in the private sector. The government should use its influence with trade associations to take such initiatives as will make strong intervention by government unnecessary. Where relatively unobtrusive interventions, such as licensing, can facilitate such development or make private sector programs more effective, then the licensing authority should be asserted. For each of the principal requirements--establishing standards, assuring compliance, and providing insurance--the government should be the court of last resort. Where the private sector efforts fail to provide adequate coverage, the government must take action.

A capsule summary of the approaches is that consumer-financed insurance appears to be the least potent of the four. It stands high on some criteria: it places no burden on merchants, it is easy to implement, it has acceptable administrative costs, and it is relatively immune to abuse. Its flaws are its burdens on the consumer and its restriction to the relatively affluent consumer. It cannot be extended to cover the disadvantaged sectors of the population.

A merchant-financed insurance scheme avoids most of the weaknesses of the consumer-financed program. But it would be far more difficult to implement. While some version might be acceptable to merchant associations as a voluntary, self-policing mechanism, any broad-scale implementation would almost certainly require major legislation.

Bonding may be a very promising approach for some market areas. The scope of bonding could be increased by making it a requirement for licensing. Voluntary bonding schemes by merchant associations (as mail order houses) should also be explored.

Creditor liability, which was strongly endorsed by the government officials contacted in Phase II, has some extremely attractive features: its long-term effect on the marketplace could be enormous. But the best routes to implementation are not clear. Some changes in the holder-in-due-course doctrine are in process, but the future status of HDC is uncertain.

Consumer priority in bankruptcy proceedings would obviously be a step in the right direction for the subset of cases where merchant insolvency currently precludes consumer recovery of loss.

Our recommendations reflect this summary. We recommend that:

- trade, industry, and commercial associations be encouraged to create insurance pools wherever feasible, and to self-police their market sector to the maximum extent possible,
- licensing and other regulatory authority be used to support private sector enforcement of standards of conduct,
- where insurance schemes are not feasible, individual merchants or neighborhood/shopping mall associations obtain bonds which guarantee the merchantability of their products,
- licensing authority be used to support/require bonding as a consumer protection device, where applicable,
- holder-in-due-course be modified to make creditors liable for transactions which they finance; demonstrations of this approach should be carefully documented,
- bankruptcy courts examine creditor priority to produce more equitable treatment of consumers,
- government action vis-a-vis insurance, bonding or other coverage schemes, be taken wherever private sector action is inadequate to protect consumers.

2.5.3 EVALUATION

Table 2.5 presents our assessment of these approaches on the set of criteria. No comment on the entries seems necessary.

Table 2.5 Coverage Mechanisms

	Bonding	Insurance		Creditor Liability	Bankruptcy Reform
		merchant financed	consumer financed		
BURDEN — On merchant	Low for reputable; high for dishonest	Moderate; reduced over time	None	None, based on current evidence	Tighter credit for marginal sellers
BURDEN — On consumer	None	Possible small cost pass-through	Very high	None	Significant to minimal, depending on reform
EASE OF IMPLEMENTATION	Could require legislation; could be adopted voluntarily by merchant associations	Could require legislation to be effective	Very easy	Requires legislative or regulatory or judicial intervention	Relatively easy; internal reform by bankruptcy courts; some new legislation
ADMINISTRATIVE COSTS	Acceptable; some pass-through to merchants, consumers	Some new functions for association or an FCIC	Acceptable	Uncertain; probably acceptable	Moderate
SUSCEPTIBILITY TO ABUSE	Relatively immune	Some policing required	Low; almost immune	Relatively immune	Relatively immune
INTERFACE WITH OTHER INTERVENTIONS	Minimal; consumer education could support usefulness	Might reduce consumer education efforts—reduce consumer vigilance	None	Consumer education supportive	None
SCOPE — General	Uncertain; probably narrow	Very broad	Broad in areas covered; very narrow in population covered	Uncertain; might be broad but not representative	Broad but not sufficient
SCOPE — Specific	N.A.	N.A.	N.A.	N.A.	N.A.
PAY-OFF — Short-term	Minimal	Significant	Significant for those covered; no spread of impact	Significant	Significant
PAY-OFF — Long-term	Significant	Very significant	Does not differ from short-term	Very significant	Significant

2.6 Document Simplification

2.6.1 NATURE OF THE PROBLEM

Many consumer transactions involve documents. Some of these documents are important in their own right, but peripheral to the transaction. A one-page instruction on how to assemble a just-purchased Siamese Fighting Kite is an example. The consumer will feel frustrated, but not cheated, if he or she has difficulty in understanding the instruction. Other documents are central features of the transaction; examples include credit applications, retail sales agreements, future service contracts, rental agreements, and warranties.* Most of these documents require the consumer's signature, thereby legally binding the individual to the terms and conditions stated in the document. Quite aside from the intrinsic fairness of the "agreed-upon" terms, there is an implicit agreement that both parties understand what it is that they're agreeing to. And many documents conspicuously fail to produce equivalent understanding by the two parties. The consumer is inevitably disadvantaged. This frequently results in instances of consumer abuse.

Several types of written documents were used in the reported transactions. The most common include: future service contracts (especially among home improvements, self-improvements such as health spas, and business opportunities); sales agreements (both automotive and home-related); repair contracts (automative and home-related); credit contracts; and product/service warranties. Consumer abuses related to the written documents include: merchant refusal to honor a warranty; performance of unauthorized repairs; addition of extra charges to original contract; substitution of items or services for those originally agreed upon; merchant failure to provide a refund; failure to deliver a product or service.

The case histories disclose two critical aspects of these transactions. One is that consumers often do not read the written agreements. This failure may be due to the length and appearance of the document which is forbidding to most consumers, and especially to poor readers who are embarrassed at the time required to read it. Because people do not read the documents and are therefore unaware of their obligations, a second factor favoring abuse comes into play. Consumers often rely on the oral representation made by a salesperson "during" the signing. As any reader of Action Line knows, what the automobile salesperson offers may differ greatly from what the written contract guarantees.

Improving the comprehensibility of all consumer documents is certainly desirable. In this intervention strategy, however, the focus is on documents where language simplification creates a balance in the information held by the merchant and the

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* The need for document simplification was noted in the Payment Planning and Post-Sale Alternatives sections.

consumer. Information equality has the potential for minimizing the incidence of abuse in the marketplace. Warranties, sales agreements, and future service contracts meet such criteria. Understanding the terms of a contract without relying on the seller's interpretation enhances a consumer's ability to decide whether or not to engage in the transaction. A consumer document should serve functionally by enabling a consumer to locate his or her obligations with respect to a particular situation, should it become necessary at some later date.

2.6.2 ANALYSIS

Document simplification deals with the comprehensibility of a message, not with its intrinsic fairness. Such *content* issues as cooling-off periods, pre-payment and refund formulas, and terms of warranty are treated in other strategies. Here we are concerned solely with consumer understanding of the transaction he or she is about to enter; interest therefore centers on the *form* of the document. There are three characteristics which describe current weaknesses and which define the routes to be followed in improving documents. These are:

The *organization* of the document. Many documents in current use have no logical arrangement of the terms of the agreement. Obligations of the buyer and seller are intermingled almost randomly. A particular topic may be treated in widely separated sections, placing unreasonable demands on memory. There is no excuse for organization of this kind; a technology exists for producing well-organized documents, and many examples exist. Banks have taken the lead in using this technology to produce Consumer Loan Agreements, for example, where the organization facilitates rather than interferes with consumer understanding.

The *language* used. There are many weaknesses in this area. One is the unnecessary use of legalese--words such as witnesseth, assignee, co-maker, and the like. Such terms are not used in everyday language and are not required in legal documents. Their use separates the layman (consumer) from the club of professionals who are familiar with this "legal language". Unnecessarily long and complex sentences are also frequent. One document examined contained a 200-word sentence which "explained" the consequences of a late payment. Another weakness is simply bad writing--non-parallel construction, non-grammatical sentences, and inclusion of excess words. Again, there are existing examples of documents which are written in "plain English," with common vocabulary, simple construction, and uncluttered sentences. Within limits, there is a technology capable of producing clearly written (and hence understandable) messages.

The *layout, graphics, and typography* used. Failure to read the small print is frequently noted; there is, in fact, considerable evidence that size of type is an important determiner of both what is read carefully, and what is understood. Some documents are essentially

one very long paragraph (in layout, not in actual content) with no headings or sub-headings to facilitate either scanning or reading. It is not surprising that consumers often make almost no attempt to even read the documents which are involved in a transaction. A well-designed document is one where each feature of the layout contributes to consumer comprehension.

In the example which follows, we cite the disclosure rule for cooling-off periods in connection with door-to-door sales. The statement below must be attached to the contract, be printed in ten-point bold face type, and stated in the same language as that used in the contract.

> You may cancel this transaction, without any penalty or obligation, within three business days from the above date.
>
> If you cancel, any property traded in, any payments made by you under the contract or sale, and any negotiable instrument executed by you will be returned within 10 business days following receipt by the seller of your cancellation notice and any security interest arising out of the transaction will be cancelled.
>
> If you cancel, you must make available to the seller at your residence, in substantially as good condition as when received, any goods delivered to you under this contract or sale, or you may, if you wish, comply with the instructions of the seller regarding the return shipment of the goods at the seller's expense and risk.
>
> If you do make the goods available to the seller and the seller does not pick them up within 20 days of the date of your notice of cancellation, you may retain or dispose of the goods without any further obligation. If you fail to make the goods available to the seller, or if you agree to return the goods to the seller and fail to do so, then you remain liable for performance of all obligations under the contract.
>
> To cancel this transaction, mail or deliver a signed and dated copy of this cancellation notice or any other written notice, or send a telegram, to (Name of seller), at (address of seller's place of business) not later than midnight of _____.*
> (Date)

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* *Code of Federal Regulations*, Volume V, 16, section 429, pp. 428-429.

Our simplified version of the cancellation clause represents a change of form over substance. This type of change will improve the comprehensibility of disclosure and thus provide the consumer with information that *could* preclude subsequent suffering.

If you want to change your mind about this purchase, you may cancel your agreement within three days (not counting Saturday, Sunday or holidays) from the date you signed the contract.

To cancel,
YOU MUST do A or B:

A. If you did NOT RECEIVE ANY GOODS from the seller, you only have to . . .

Send the cancellation notice (by mail, telegram or personal delivery) to _____
at _____ by midnight of ____.

B. If you RECEIVED GOODS from the seller you must . . .

Send the cancellation notice (by mail, telegram or personal delivery) to _____
at _____ by midnight of ____.

and YOU MUST also decide whether to:

- Follow the seller's instructions and return the goods at his expense and risk;

OR

- Allow the seller to come back to your home and pick up the goods; don't let anything happen to the goods before the seller arrives.

If you cancel,
SELLER must:

- Return anything you gave up at the time of the sale (money or property or documents) within 10 days after the seller receives your notice;

AND

- Let you keep the goods if no one claims them within 20 days after receipt of your notice.

Several times in this report, we noted the need for improving written contracts between a merchant and a consumer as one step leading to a reduction of opportunities for consumer loss. The current weaknesses in existing contracts offer ideas for suggesting minimum requirements for written agreements. We suggest the following:

Payment Plan. Includes payments based on performance, conditions of final payment, schedule of installments. Specify interest rates and all credit terms. Build in escrow account if possible.

Work Plan. Develop time line that shows the period of performance for each task. Allow for reasonable delays; specify what constitutes a reasonable delay. Include penalty clauses for noncompetition when scheduled. Request performance bond.

Warranty. Specify condition of delivery, replacement policy for damaged or defective merchandise, time period of guarantee.

Paper Disclosures. Includes cancellation rights, affirmation requirements, trial periods, cooling-off period.

Refund Standards. Important for future service contracts. When consumer only partially uses agreed-upon services.

There is no need to initiate a document simplification movement; it is already underway in both public and private sectors.

- New York has passed a "plain English" law; many other states have legislation pending.
- The President of the United States has directed that Federal regulations be written so as to be understandable by the people who are affected.
- The St. Paul Fire and Marine Insurance Company has rewritten its Personal Liability Catastrophe Policy in simple language; it is formatted to facilitate location of topics.
- Citibank, National Bank of Washington, and other banks have produced simplified consumer loan notes.
- The Caterpillar Tractor Company has developed an 800-word Fundamental Vocabulary for use in all technical instructions regarding the company's products.

Our proposals therefore concern augmenting a development which has appreciable momentum at the present time. We suggest that:

- existing regulations be strengthened by adding provisions which call for plain English, logical organization, and proper layout for all documents produced under the regulation,
- both government and private sectors *develop standards* against which new documents may be evaluated,
- state governments work toward *model legislation* for consumer protection through document simplification,
- trade, industrial and commercial associations take the lead in extending the scope of simplified documents in their sector of the market,
- consumer education efforts stress the importance of documents to the consumer, and acquaint the consumer with models of excellence currently existing in the marketplace,
- standard forms for certain types of transaction (such as home improvements) be widely distributed directly to consumers and consumer affairs agencies.

2.6.3 EVALUATION

Our assessment of document simplification as a strategy is shown in Table 2.6. It is the simplest strategy suggested and one with high impact potential.

Table 2.6 Document Simplification

	Public Sector	Private Sector
BURDEN — On merchant	Depends on whether government provides materials or simply mandates private sector action	Negligible for large businesses; burden on small businesses could be ameliorated by government providing standard forms
BURDEN — On consumer	None	None
EASE OF IMPLEMENTATION	Would require legislation to require clarification of regulations	Very easy; voluntary action underway. 22 states have legislative action pending
ADMINISTRATIVE COSTS	Negligible	Negligible
SUSCEPTIBILITY TO ABUSE	Very low	Very low
INTERFACE WITH OTHER INTERVENTIONS	Facilitative in all cases	No negative impact; facilitates informal and legal adjustments
SCOPE — General	Very broad	Very broad
SCOPE — Specific	Government-linked credit agreement—HUD, FHA	Sales contracts, performance agreements, warranties
PAY-OFF — Short-term	High potential, low guarantee	High potential; low guarantee
PAY-OFF — Long-term	Very significant	Very significant

2.6.3.1 *Burden on merchant and consumer.* Whether or not an unreasonable demand is placed on the merchant will depend on who assumes developmental responsibility for redesigned documents. If the government designed standardized forms, then disseminated them to potential users, the merchant would not be unnecessarily encumbered. Large businesses in the private sector could easily underwrite a document simplification activity; smaller merchants may find it difficult to afford similar investments. No burden on the consumer.

2.6.3.2 *Ease of implementation.* Significant impact is linked to legislation and/or a strengthening of existing regulations. Non-technical rule changing, when appropriate, short circuits some agency procedures. Form is easier and quicker to change than substance. Industries can adopt standards that demonstrate a commitment to clear and understandable warranties or sales contracts.

2.6.3.3 *Administrative costs.* Negligible in public and private sectors. No newly created bureaucratic layers required; perhaps minor functional changes of existing ones.

2.6.3.4 *Susceptibility to abuse.* Very low in both cases. Since the "plain English" contracts have not yet reached the courts, some testing of the statutory language will no doubt occur.

2.6.3.5 *Interfaces with other interventions.* Facilitative and highly desirable as discussed several times throughout this report.

2.6.3.6 *Scope: general and specific.* Overall, very broad. As a first step, any government-linked credit agreement could be revised. Other opportunities exist in current regulations that require one further step before consumers can be informed - for example, implicit within the notion of disclosure is that the consumer comprehend what is being disclosed. That requirement is not being met. Among private businesses, the document simplification strategy can be applied to any performance contract, future service agreement, product or service repair contract, or warranty.

2.6.3.7 *Pay-off.* Short-term and long-term. The entries are self-explanatory.

3. RECOMMENDATIONS FOR ACTION

In the preceding section, we reviewed sixteen approaches to reducing consumer abuse. For each approach, we discussed the obstacles which have limited past effectiveness and considered some of the ways in which these might be overcome. We do not consider these discussions to be definitive; we do hope that the appropriate issues have been raised, and that the discussions indicate some of the directions which further inquiry might take.

In an attempt to provide a common frame of reference for viewing a very diverse set of approaches, each was assessed on a standard set of dimensions. These evaluative judgments are admittedly crude, and necessarily so. A very specific action plan derived from any one approach might be assessed more precisely. A general approach is not amenable to such precision.

An assessment of feasibility is extremely difficult, even for plans at a more specific level than those presented. But some estimate of feasibility must enter into a consideration of priorities for action. We are certain that considerations of this kind have influenced our judgments, but we cannot specify either how or how much. At a conscious level, our judgments are governed by a *least drastic alternative* principle, which looks toward private sector solutions before seeking government intervention. In this context, we list seven priorities for action. We believe these to be feasible in the relatively short-term. If all targets were met, the frequency of consumer fraud and abuse would be greatly reduced. We cannot know whether these actions would be *sufficient*, or whether additional interventions would still be necessary. After listing the targets, we consider some implementing actions in both private and public sectors.

3.1 The Priority Targets

Restrict prepayments to the absolute minimum required to protect the honest merchant. Where there is no logical requirement for prepayment, permit none.

Require escrow in areas where consumer abuse is frequent, and where merchant use of consumer funds is a convenience rather than a necessity.

Make mediation services widely available. To the maximum extent possible, these less formal mechanisms should be used in preference to the more cumbersome and more expensive machinery of the courts.

Make maximum use of bonding and insurance approaches to protect consumers; these mechanisms should be applied to most sectors of the market.

Make maximum use of existing authority under licensing and registration statutes. The potential of licensing for restricting the market to honest merchants is far greater than current licensing practices achieve.

Relax the holder-in-due-course doctrine, so that creditors will share liability for the transactions which they support through financing.

For every *document* which figures in a transaction, *require that it be comprehensible* to the consumers who are affected.

3.2 Recommended Actions by the Private Sector

By industry, trade, and commercial associations

- Establish standards of conduct. Ethical standards for most professions are formulated by members of the profession. For some, these standards are incorporated as licensing requirements which are administered by some agency of government. There are approximately three thousand national trade, industry, and commercial associations. Many have established standards, many others have not; some take compliance with standards seriously, others do not. Enlightened self-interest decrees that every such association should establish standards of conduct and require compliance as a condition for membership.

- Where licensing is required, press licensing authorities to incorporate standards as requirements for licensing.

- Establish incentives for compliance and self-policing by the membership.

- Where feasible, create member-financed insurance pools to protect consumers against members who violate standards.

- Where insurance is not feasible, encourage use of bonding by members. Consider a requirement that members be bonded.

- Create models of excellence for all documents which are used in member-consumer transactions.

- Encourage the use of standard contracts, sales agreements, and the like, which use clear and simple language.

- Advertise all of the above, so that consumers will know what they should expect, and can find, in the marketplace.

By individual merchants

- Adopt standards, compliance mechanisms, simplified forms, etc., developed by associations or large businesses.

- Work through Chamber of Commerce or other business associations to bring about developments listed in 3.2 on the previous page.

- Where practicable, obtain bonding.

By individual consumers. All recommendations for indiviudal action can be summarized in the gratuitous advice that consumers should learn to be effective consumers. Self-education occurs and is extremely effective, but efforts to expand it to harder-to-reach and more-at-risk segments of the population have not been successful. We will consider consumer education in subsequent sections.

3.3 Recommended Actions by State and Local Government

- Stimulate and support all consumer-protective activities occurring in the private sector. Establish industry-government councils where appropriate to further these developments.

- Use licensing authority to promote compliance with standards of conduct.

- Establish mediation services as a joint citizen-merchant-local government mechanism to achieve inexpensive resolution of conflicts which arise in the marketplace.

- Where private sector action is sluggish or ineffective, invoke or create regulatory authority to prevent consumer abuse.

- Where private sector action is sincere but not sufficient, consider public or quasi-public management of consumer insurance.

- Require that all government-produced documents which affect the consumer or merchant-consumer transactions, be written in simple and comprehensible language.

- Develop and disseminate materials to educate consumers.

- Create mechanisms to assemble and synthesize information currently being collected by consumer affairs units; make this information available to all potential users.

- Identify market areas where abuse is frequent, and where legislative action seems required.

- Examine proposed and existing legislation in own and other jurisdictions; adopt models which have been effective elsewhere.

3.4 Recommended Actions at the Federal Level

- Stimulate action in the private sector, both by facilitative mechanisms and by involving the threat of Federal intervention.

- Provide technical assistance, in a variety of forms, to state and local governments, and to the private sector. Technical assistance might include seminars and workshops, dissemination of models of excellence, and on-site assistance in both formulating and implementing strategies.

- Use discretionary funds to augment actions underway in the private and local government sectors.

- Monitor the state of the consumer in the marketplace, by assembling information being collected throughout the nation. No new reporting requirements need be invoked, but the use of standard forms should be encouraged. Publish an annual report so that progress can be charted and areas of concern identified.

- For remaining areas of concern, invoke existing regulatory authority to prevent continuing abuse.

- Where existing, regulatory authority is inadequate, examine existing and proposed legislation at both State and Federal level. Consider legislative remedies as the last resort; when invoked, adopt existing models of excellence, modified as necessary.

- If necessary, consider public or quasi-public management at the Federal level, of consumer insurance.

- Continue the current Federal initiative toward document simplification.

APPENDICES

Appendix A. Characteristics of Phase I Data Sources

Source of Data

Characteristic	Amerian Association of Retired Persons *	Attorney General, Phoenix	Call for Action	District Attorney, Sacramento **	Federal Trade Commission *	Miami Police Fraud/ Forgery Detail	Economic Crime Project *	Neighborhood Legal Services Program *	Governor's Office of Consumer Affairs, Atlanta	Montgomery County, Md. Office of Consumer Affairs	United States Postal Service *
Type of Agency	Privately funded	State	Privately funded	County	Federal	City	Publicly funded	Publicly funded	State	County	Federal
Special Consumer Fraud Component	National Consumer Assistance Center	Economic Protection Div., Consumer Fraud Section	–	Fraud Division	Bureau of Consumer Protection	Fraud and Forgery Detail	–	–	–	–	Postal Inspection Service
Age of Agency or Special Consumer Fraud Component (in years)	4	2	14	8	63	?	3	12 (approx)	2	6	6
Mandate	Seek consumer redress for retired persons	Process consumer complaints and enforce state consumer fraud law	Provide consumer assistance through restitution and referral	Respond to consumer complaints; enforce state and county consumer protection laws; monitor and support or oppose new consumer legislation; educate consumers	Enforce federal consumer laws prohibiting unfair or deceptive practices affecting commerce; educate consumers	Investigate suspected consumer fraud cases as well as such other offenses as forged checks and unauthorized use of credit cards	Reduce, prevent, and control economic crime; coordinate efforts of and help establish new economic crime units; educate consumers	Provide free legal advice and representation to those unable to pay lawyers in all types of civil matters; educate the poor as to their legal rights	Protect consumers against deceptive practices; educate consumers	Enforce county law prohibiting unfair or deceptive practices; assist consumers; educate consumers	Enforce federal mail fraud laws; assist consumers with complaints of unsatisfactory mail order transactions
Staff: Regular***	1	?	5 (national office)	13	?	6	5 (national office)	Varies by program	Tie-line 12	24	?
Volunteer	4		2500 (nationwide)	–		–	–		I & E 5	6.6 person years	
Geographical Scope of Activities	National	State	National	County	National	City	National	National	State	County	National
Population Served	Elderly	General public	General public	General public	General public	General public	General public	Poor	General public	General public	General public
Origin of Cases	Consumers	Consumers	Consumers	Consumers; referrals from other agencies; agency initiated investigations	Consumers; own investigations; businesses; trade organizations; other agencies	Criminal Investigations Section	Consumers	Consumers	Consumers	Consumers	Consumers; other agencies
Inquiries Received	3,100 to 3,900 (yearly average)	5,750 (1975)	202,611 (1978) Projection	910 (1978) Jan. - June	?	?	157,250 (1975)	Varies by program	50,000 (1977 projected)	5,900 (FY77)	198,917 (FY77)
Investigations Opened	952	4,251 (FY77)	?	108 (1978) Jan. - June	?	1,350 (1976)	4,000 (1975)	Varies by program	5,000 (1977 projected)	?	5,800 (1976)
Resolves Individual Complaints	(1977)	Yes	Yes	Yes	No	Yes	Varies by office	Yes	Yes	Yes	No
Seeks Restitution for Individuals	Yes	Yes	Yes	Yes	No	Yes	Varies by office	Yes	Yes	Yes	No
Seeks Restitution for Classes	No	Yes	No	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Most Complaints Referred to Another Agency	Yes	No	Yes	No	No	No	No	No	Yes	No	No
Enforcement Mechanisms	None	Industry-wide investigations; civil actions seeking costs of investigation and prosecution, restitution, and fines; Issue Assurance of Discontinuance	Use of media; Consumer Beware	Civil actions seeking costs of investigation and prosecution, injunctions, restitution, and fines; criminal prosecution	Promulgate binding trade regulation rules; industry-wide investigations; investigational subpoenas and hearings; cease and desist orders; civic injunctions for violations of rules or orders; civil actions seeking fines, restitution, other consumer redress	Arrest; referral for criminal prosecution	Depending on jurisdiction, civil actions seeking costs of investigation and prosecution, injunctions, restitution, and fines and/or criminal prosecution	Legal advocacy before agencies and in state and federal courts	Investigational subpoenas and hearings; injunctions; referral to Attorney General, who may seek injunctions and fines; Issues Assurance of Voluntary Compliance	Investigational subpoenas and hearings; binding arbitration, (by consent); cease and desist orders, including costs of investigation; referral for legal action, including injunction, fines, and restitution	Administrative action resulting in order letters returned to sender, prevent payment of postal money orders, referral to Department of Justice for criminal prosecution and possible restitution.

* Reflect nation-wide data.

** Participant in Economic Crime Project

*** Refers to full and part-time personnel/attorneys, paralegals, investigators.

Appendix B. Characteristics of Phase II Data Sources

Characteristic	Source of Data: Consumer Affairs Department, Detroit, Michigan	Office of the Attorney General, Bureau of Consumer Protection, Philadelphia, Pennsylvania	The City of New York, Department of Consumer Affairs, New York City	Department of Justice, Office of Consumer Protection, Madison, Wisconsin	Consumer Protection Division, Iowa Department of Justice, Des Moines, Iowa	Office of the Prosecuting Attorney, Consumer Affairs Office, Flint, Michigan	Office of the Prosecuting Attorney, Fraud Division, King County, Seattle, Wash.	Office of the Attorney General, Consumer Protection Division, Seattle, Washington	State of Colorado, Metropolitan Denver District Attny. Consumer Office, Denver, Colorado	Office of the District Attorney, Consumer Fraud/White Collar Crime Unit, San Francisco, Calif.
Type of Agency	City	State	City	State	State	County	County	State	Multi-county	City and county
Special Consumer Fraud Component	Consumer Affairs Department	Bureau of Consumer Protection	Department of Consumer Affairs	Office of Consumer Protection	Consumer Protection Division	Consumer Affairs Office	Fraud Division	Consumer Protection Division		Consumer Fraud/ White Collar Crime Unit
Age of Agency or Special Consumer Fraud Component (yrs.)	Since 1974 (4 years)	Since 1971 (7 years)	Since 1968 (10 years)	Since 1970 (8 years)					5 years	
Mandate	Conduct research and develop programs for consumer education and protection; enforce laws and ordinances prohibiting false advertising, offering for sale, and sale of goods and services, within limits, grant, revoke, approve transfers of licenses,permits and collect fees for these, process consumer complaints	Investigate and mediate consumer complaints, take legal action against companies accused of unfair practices, educate consumers, special LEAA grant for 1) Strike Force to work on consumer actions having statewide impact; 2) Community service program to serve consumer protection needs of poor	Process consumer comp complaints, enforce Consumer Protection Act, educate consumers	Process consumer complaints, enforce state consumer protection laws, provide consumer information and education	Process consumer complaints; enforce state consumer fraud law	Enforce consumer protection act; process consumer complaints; participate in 2-hour weekly radio show where listeners call in with consumer questions	Deter economic crime, including violations of regulatory provisions, abuse of trust involving public, private funds and frauds against government agencies; obtain restitution for victims, punish offenders.	Enforce consumer protection and trade laws of state for the benefit of the public; process consumer complaints, educate consumers	Enforce civil state Consumer Protection Act; enforce state criminal laws; mediate complaints, referrals; provide information, educate consumers, conduct weekly half hour radio program (Dial-a-Fraud)	Protect consumers and legitimate businesses from fraudulent and oppressive acts or practices that affect the community as a whole; special project: outreach through use of "Complaint-Mobile"
Staff	reg = 16, 3 times a year gets CETA trainees, Urban Corps, college students, college students doing work study vol = Yes	reg = 80+	vol = more than paid staff	reg = 8 attorneys, 9 investigators, 2 consumer information specialists, 3 complaint specialists		reg = 3 attorneys, 12 investigators		reg = claims investigators, law clerks, students from federally-funded work study program vol = trained volunteers	reg = 15 plus 2 CETA clerks, paralegal vol = student interns, volunteers	reg = 26 vol = 20-30 student interns
Geographical Scope of Activities	City	State	City	State	State	County	County	State (four separate offices)	Multi-county	City and county
Population Served	General public	General public	General public	General public	General public	General public	General public	General public	General public	General public
Origin of Cases	Consumers, referrals from toher agencies	Consumers	Consumers	Consumers, referrals from other agencies	Consumers	Consumers, referrals from other agencies, agency-initiated investigations		Consumers, agency-initiated investigations, other referrals	Consumers, referrals from other agencies agency-initiated investigations	Consumers, referrals from other agencies agency-initiated investigations
Inquiries Received	270 (May, June 1977)	97,893 (1977)		8,564 (Jan.- August 1977)	4,443 - Jan. to June 1978	4,200 (1977)	a. 2,500	13,316 - 1977; 9,006 - 1978	13,316 (1977)	2,400 (9 months, 1977)
Investigations Opened	–	–	?	?	?	3,235 - 1976	70 cases filed (1977*)	–	5,713 received preliminary investigation (1977)	–
Resolves Individual Complaints	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes Jan. - June 1978 - 1041
Seeks Restitution for Individuals	Yes	Yes	Yes	Yes	Yes	Yes	–	Yes	Yes	Yes
Seeks Restitution for Classes	Yes	?	Yes	?	Yes	Yes	–	No	Yes	No
Most Complaints Referred to Another Agency	?	?	Yes	No	No	–	Yes?	–	Yes	–
Enforcement Mechanisms	Temporary/ permanent injunction, subpoena witnesses, administer oaths, take testimony, require production of evidence, promulgate rules, must go through other city departments to issue citations	Civil actions, restitution, power to issue rules and regulations, injunction, assurance of voluntary compliance	Conduct investigations, hold public and private hearings, recommend fines, issue subpoenas, serve court summons to unlicensed businesses, promulgate regulations, go to court to seek remedies for violations, including civil penalties, criminal fines, injunctions, restitutions, suspend/revoke licenses	Civil forfeiture, criminal prosecution seeking fines and/or imprisonment, injunctions, restitution, voluntary assurances of discontinuance, revocation of corporate authority for violation of Department of Agriculture orders	Civil actions, seeking costs of investigation and prosecution, restitution, fines, injunction, criminal prosecution	Notice of Intended Action, subpoena for testimony and records, sue for injunctions/ damages, assurances of discontinuance, Class Action suits	Civil and criminal prosecution of categories listed in No. 4, seeking to deter crimes, obtain restitution for victims, punish offenders	Company specific and industry-wide investigations, formal/informal Assurance of Discontinuance, serve complaints, motion for preliminary injunction and an order to show cause, file lawsuit on behalf of the people of the state	Civil actions seeking costs of investigation and prosecution, restitutions, criminal prosecution, referral to county of venue for further investigation, grand jury action, prosecution	Civil actions seeking injunctions, fines and restitution; criminal actions seeking jail terms or probation with conditions like restitution, restraint from illegal conduct and public service depending on seriousness of crime

Appendix C. Data Acquisition Form

CONSUMER FRAUD
Data Acquisition Form

Date _____ AIR case no. ___ ___ ___ ___ (1 2 3 4)

Agency ___ ___ (5 6)

DESCRIPTIVE INFORMATION

1. **Type of Product or Service Involved:** Product, Service, Other, Unknown ___ ___ ___ (7 8 9)
   If not on list, specify: _____
2. **Consumer Characteristics:** A. Age B. Occupational status C. Sex D. Residence ___ ___ ___ ___ (10 11 12 13)
3. **Merchant characteristics:** A. Is merchant solvent? B. Available? C. Other complaints filed ___ ___ ___ (14 15 16)
4. **Other Involved Parties:** If not on list, specify: _____ ___ ___ (17 18)
5. **Initial Contact:** If not on list, specify: _____ ___ (19)
6. **Nature of Complaint:** If not on list, specify: _____ ___ ___ (20 21)
7. **Primary Medium Used:** If not on list, specify: _____ ___ ___ (22 23)
8. **Dollars Involved in the Individual Transaction:** If not on list, specify: _____ ___ ___ (24 25)
9. **Public Loss:** If not on list, specify: _____ ___ ___ (26 27)
10. **Agency Receiving Complaint:** If not on list, specify: _____ ___ ___ (28 29)
11. **Source of Complaint:** If not on list, specify: _____ ___ ___ ___ ___ (30 31 32 33)
12. **Relief Sought:** If not on list, specify: _____ ___ (34)
13. **Primary or Secondary Agency:** If not on list, specify: _____ ___ (35)
14. **Action Taken by Agency:** If not on list, specify: _____ ___ ___ (36 37)
15. **Results of Action Taken by Agency:** ___ ___ ___ ___ ___ (38 39 40 41 42)
    If not on list, specify: _____ ___ ___ ___ ___ (43 44 45 46)
16. **Relief Obtained:** If not on list, specify: _____ ___ ___ (47 48)

INDUCEMENT

1. **Was the offer for a business or investment opportunity?**
   If not on list, specify: _____ ___ ___ (49 50)
2. **Did the offer include claims for consumer self-improvement?**
   If not on list, specify: _____ ___ ___ (51 52)
3. **Did the offer include claims of unique features not found in competitive line?**
   If not on list, specify: _____ ___ ___ (53 54)
4. **Did the offer include claims of substantial savings?**
   If not on list, specify: _____ ___ ___ (55 56)
5. **Did the offer include an implied or expressed warranty, guarantee, or cancellation clause?**
   If not on list, specify: _____ ___ ___ (57 58)
6. **Did the offer include or imply time pressure?**
   If not on list, specify: _____ ___ ___ (59 60)
7. **Did the merchant suggest an additional product or service?**
   If not on list, specify: _____ ___ ___ (61 62)

OBLIGATION OR AGREEMENT: If not on list, specify: _____ ___ ___ (63 64)

POSTPAYMENT: If not on list, specify: _____ ___ ___ (65 66)

MERCHANT RESPONSE: If not on list, specify: _____ ___ ___ (67 68)

Coder comments:

AIR-10/77

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